S. HRG. 104–396

THE COST OF FEDERAL REGULATIONS ON SMALL BUSINESS

JOINT HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE

AND THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

OCTOBER 31, 1995

H. HRG. 104–57

Printed for the use of the Committees on Small Business of the U.S. Senate and the House of Representatives

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THE COST OF FEDERAL REGULATIONS ON SMALL BUSINESS

TUESDAY, OCTOBER 31, 1995

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS,
AND HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The Committees met jointly, pursuant to notice, at 10:04 a.m., in room G–50, Dirksen Senate Office Building, the Honorable Christopher S. Bond, Chairman of the Senate Committee, and the Honorable Jan Meyers, Chairman of the House Committee, presiding.

Present: Senators Bond, Burns, Coverdell, Hutchison, Frist, Snowe, and Bumpers; Representatives Meyers, Torkildsen, Bartlett, Kelly, Skelton, Flake, Poshard, Meehan, Velazquez, Luther, and Baldacci.

OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, CHAIRMAN, SENATE COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MISSOURI

Chairman BOND. The joint hearing of the House and Senate Committees on Small Business will come to order. Good morning, and thanks to all of you for attending this morning's hearing on the cost of Federal regulations on small business. I extend a very special and warm welcome to our colleagues from the House side. We are delighted that you could join us here today.

Today's special joint hearing of the House and Senate Small Business Committees is being held to receive a report to Congress from the chief counsel for advocacy at the Small Business Administration. The chief counsel, Mr. Jere Glover, is with us today and will testify on the findings of the report: The Changing Burden of Regulation, Paperwork, and Tax Compliance on Small Business. I welcome Mr. Glover back to the Committee and I look forward to his testimony.

The Senate Committee on Small Business has held several hearings on "Entrepreneurship in America" that have shown us the very real barriers to small business expansion caused by excessive Federal regulation. These hearings, some held here in Washington and others held at several places around the country, have permitted individual small business owners to tell their personal stories about how their businesses have been severely affected by Government regulations. While these individual small business stories have been very helpful to the Committee, they have been only anecdotal evidence of the regulatory problems faced by small busi-

ness. In addition to the hearings that we have held around the country, we have the reports of the White House Conference on Small Business which also pointed to the same problems with Government regulation.

But the report being released today by the chief counsel takes a new, comprehensive look at whether small businesses bear a disproportionate burden of regulatory costs. While I do not want to steal your thunder, Mr. Glover, I think it is fair to say that this report breaks new ground in assessing the burden placed on small business by Government regulation particularly as it relates to manufacturing businesses. It confirms what many of us have long suspected, and what our series of field hearings has suggested, and that is that small business bears more than its fair share of the cost of regulations.

One of the most important conclusions of the report is this: Because small business occupies a central role in achieving our national goals of generating new employment and innovation, improving our global competitiveness, and encouraging economic growth, Government actions should not impose disproportionate cost burdens on the small business sector of our economy. I could not agree more. Our field hearings have clearly shown that this disproportionate burden creates serious obstacles for small businessmen and women across the country. The need to reform regulations and the laws that produce them could not be more clear.

If there is one message I hope the members and the press will take away from today's hearing it is that when small business loses, we all lose. The particularly high cost of regulation on small business poses a significant barrier to small business growth and handicaps the new, innovative entrepreneur in competing successfully in the marketplace—that kills jobs, stifles innovation, and hurts our international competitiveness.

With those remarks, I look forward to hearing Mr. Glover's testimony on the specific findings of the report. We have indicated to our members that the chair and ranking members will make comments, and we will ask the other members of the Committees either to submit their opening comments for the record or to include them in the question and answer session. We will go according to the first-come, first-served basis, alternating back and forth.

With that, I call on my good friend and colleague, and the cochair of this joint hearing, Chairwoman Jan Meyers of Kansas, to make an opening statement. Welcome.

OPENING STATEMENT OF THE HONORABLE JAN MEYERS, CHAIR, HOUSE COMMITTEE ON SMALL BUSINESS, AND A REPRESENTATIVE IN CONGRESS FROM KANSAS

Chairwoman MEYERS. Thank you, Senator Bond. We are glad to be here, and thank you for inviting us over for this joint hearing.

I want to welcome all of our House and Senate colleagues to this morning's hearing. This is the first joint hearing of the two Small Business Committees in nearly two decades. Where it makes sense, I hope that we can have other hearings together so that they can operate as a forum for the small business community. I also want to welcome Jere Glover, our sole presenter for this hearing's appropriate and timely subject matter.

The chief counsel's quintessential message will be the aggregate costs of Federal regulation, paperwork, and tax compliance are huge, and that they impact small businesses more than big businesses. Given the vital and compelling role small businesses play in new job creation and in our Nation's capacity for economic growth, the details of this message are very important.

For example, one conclusion is that the regulatory cost of regulations for small firms is some 50 percent more than the cost to large firms. This key finding establishes an appropriate perspective for prompt action on eliminating unnecessary regulatory compliance costs. The entrepreneurial spirit engendered by new small businesses needs to be encouraged and not disproportionately discouraged.

The details of this message are timely as well. Many of us on both sides of the aisle, in both bodies, voted to strengthen the Regulatory Flexibility Act of 1980. We also sensed the need to bring some sound research, and more concrete numbers, to further bolster the bedrock proposition that small businesses merit different consideration than larger firms.

When the study suggests that a firm with fewer than 500 employees pays about $5,000 per employee in regulatory and tax compliance costs, we should keep in mind that we are talking about dollars spent because of Government demands. They are off-budget consequences. They are like hidden taxes, if you will, that flow from Federal programs. Disciplining these costs can be as, or even more important for the competitiveness of small business, than is balancing the budget.

Earlier in this Congress, the House passed Regulatory Flexibility Act amendments as part of its "Contract With America." Like the Paperwork Reduction Act of 1995 which passed unanimously, the Regulatory Flexibility amendments were passed with overwhelming bipartisan support. The Senate is now considering "Reg Flex" amendments in the context of Senator Dole's Comprehensive Regulatory Reform Act of 1995, S. 343.

The details of the chief counsel's message are timely because they highlight for our Senate colleagues the need to pass regulatory reform legislation. We need to be sure that we take this step for small business.

Mr. Glover, I look forward to hearing you describe your findings.

[The prepared statement of Representative Meyers follows:]

PREPARED STATEMENT OF THE HONORABLE JAN MEYERS
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

I want to welcome all our House and Senate colleagues to this morning's hearing. This is, I understand, the first joint hearing of the two Small Business Committees in nearly two decades. Where it makes sense, I believe there will be other occasions where our two Committees can operate as a forum for the small business community.

I also want to welcome Jere Glover, our sole presenter for this hearing's appropriate and timely subject matter. The Chief Counsel for Advocacy is a creature of the Congress whose job is to be an independent voice and represent the small business perspective on major issues. He is appointed by the President, confirmed by the Senate, and reflects the principle purposes of the two Committees.

The Chief Counsel's quintessential message will be the aggregate costs of federal regulation, paperwork, and tax compliance are huge -- and they impact small businesses more than big businesses. Given the vital and compelling role small businesses play in new job creation and in our Nation's capacity for economic growth, the details of this message are important.

For example, one conclusion is that the regulatory cost of regulations for small firms is some 50 percent more than the cost to large firms. This key finding establishes an appropriate perspective for prompt action on eliminating unnecessary regulatory compliance costs. The entrepreneurial spirit engendered by new small businesses needs to be encouraged, not disproportionately discouraged.

The details of this message are timely as well. A year ago, in the previous Congress, I sponsored the amendment to the Small Business Administration Reauthorization Act which called for this study. Many of us on both sides of the aisle, in both bodies, voted to strengthen the Regulatory Flexibility Act of 1980. We also sensed the need to bring some sound research, and more concrete numbers, to further bolster the bedrock proposition that small businesses merit different considerations than larger firms. My hope is that this study meets that objective.

When the study suggests that a firm with fewer than 500 employees pays about $5,000 per employee in regulatory and tax compliance, we should keep in mind that we are talking about dollars spent because of Government demands which are not reflected in the spending budget. They are "off-budget" consequences, "hidden taxes" if you will, that flow from federal programs.

Disciplining these costs can be as, or even more important for the competitiveness of small business, than is balancing the budget.

Earlier in this Congress, the House passed Regulatory Flexibility Act amendments as part of its "Contract with America". Like the Paperwork Reduction Act of 1995, which passed unanimously, the "Reg Flex" amendments were passed overwhelming bipartisan support. The Senate is now considering "Reg Flex" amendments in the context of Senator Dole's Comprehensive Regulatory Reform Act of 1995, S.343.

The details of the Chief Counsel's message are timely because they highlight for our Senate colleagues the need to pass regulatory reform legislation. I join those who want to see Senator Dole's over-all regulatory reform bill pass the Senate.

I also believe that today's message complements the idea that if progress on overall regulatory reform remains stalled, the Congress should take special action to enact amendments to the "Regulatory Flexibility Act."

We need to be sure to take this step for small business.

Mr. Glover, I look forward to hearing you describe your findings.

Chairman BOND. Thank you very much, Madam Chair. Now I will turn to Senator Bumpers.

OPENING STATEMENT OF THE HONORABLE DALE BUMPERS, RANKING MINORITY MEMBER, SENATE COMMITTEE ON SMALL BUSINESS, AND A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS

Senator BUMPERS. Thank you, Mr. Chairman. First of all, welcome, Mr. Glover, and congratulations on what I think is one of the most interesting and really powerful reports I have read in my 21 years here. I must confess I have not had the chance to read every word of it, but what I have read, reads like a novel. Everybody who is interested in this issue in this country ought to read it, and they will find it not only enlightening but also fairly easy going.

We are here today, incidentally, because of a bill I had introduced last year, S. 2060, to reauthorize SBA programs. It became Public Law 103–403. When it came out of the House, the House had attached a provision that required this study be done. We agreed to the House provision in the conference report. I want to congratulate my colleagues in the House for having the foresight to request this study which we are here to discuss today.

But from a personal standpoint, I knew as a small businessman who operated a hardware, furniture, and appliance store for 15 years after I got out of law school—because I knew I could not make a living practicing law. I knew then, in the 1950's and 1960's that there was a very serious imbalance between the burdens on small business and the burdens on big business, simply if for no other reason, because you are having to comply with the same laws but the cost of administering for an employee when you have 10 employees as compared to 1,000, there is a vast chasm between the two.

When you consider the fact that 53 percent of all the people in this country work for what we describe and define as small business, you can see that the problem is really staggering. The disadvantage to small business is also staggering.

Senator Bond has introduced a bill which is now S. 530. I think Senator Bond's bill goes a long way toward addressing the problem we are talking about here today where he would reform the Reg Flex Act by permitting judicial review. I think one of the first things that the Congress ought to do is to pass Senator Bond's bill in addressing this problem.

We know that regulations are necessary. Nobody is suggesting they are not. If we are going to have safe pharmaceuticals, if we are going to have safe food, clean water to drink, and clean air to breathe, there has to be a fairly substantial regulatory process. And we will never get it right, we will never satisfy the small business community of this country. But we—as elected officials and public servants—have a really strong duty to do everything we can to not only lighten the burden on small business but do ourselves a favor by making the entire Nation thereby more competitive.

Finally, Mr. Glover, let me say that your conclusion that the time is not right for the abolition of the Office of Advocacy is one with which I totally agree. There may come a time, but I do not think it is yet. While I applauded the House in my opening statement,

I will say I disagreed strongly with them when they tried to abolish that office in the appropriations process.

I am on the Interior Conference Appropriations Committee, Mr. Chairman, which is going to meet at 10 o'clock this morning. I hope I will not be gone long and that I can get back for most of this hearing. But I want to congratulate you, both chairpersons for calling this joint session, which is unique. We should have been doing this perhaps more often. And congratulate you, Mr. Glover, for a really fine report.

Mr. GLOVER. Thank you, sir.

Chairman BOND. Thank you very much, Senator Bumpers.

Senator BUMPERS. Mr. Chairman, I ask unanimous consent that my formal remarks be inserted in the record.

Chairman BOND. I thought the informal ones were pretty good, but we will be happy to accept the formal ones.

Senator BUMPERS. Strike the unanimous consent. Everybody agrees I may be a little better extemporaneously. I will just let it stand.

Chairman BOND. We will take the written statement, too.

[The prepared statement of Senator Bumpers follows:]

OPENING STATEMENT OF SENATOR DALE BUMPERS
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

I want to commend the two Chairs for calling us together today to receive a truly significant report from the Clinton Administration's Office of Advocacy. This report, as members probably know, was required by the conference report to accompany S. 2060, a bill which I introduced last year that became P.L. 103-403. That Act reauthorized and made changes in SBA programs for the years 1995-98. Frankly, when this report was urged by House members, I did not expect that it would have nearly the merit which today's report does. We have all read too many agency reports over the years which said too little.

That is not the case today. Jere Glover and his staff, along with Professor Thomas Hopkins of the Rochester Institute of Technology, have produced the most specific, concrete and detailed information I have ever seen on a subject which both politicians and the public love to complain about -- the cost of federal regulations for business owners. This subject is much like Will Rogers statement about the weather. Perhaps now we will do more than talk about it.

I do not want to steal Mr. Glover's thunder by telling the punch line, but I believe that his conclusions will make everyone sit up and take notice. Small business, as we have long believed, does bear a huge competitive disadvantage when compared to larger firms on the issue of regulatory cost compliance. "Huge" in this case means bigger than most any of us would have guessed.

There are many possible outcomes of today's hearing. Some might use it to criticize the Clinton Administration, but that would hardly be justified since it is the Administration which has proved this case. Others might want to revive S. 343, the Dole Regulatory Reform bill which was mired in problems earlier this year. Perhaps regulators will even read this report and finally start taking this issue seriously.

One thing, however, seems inescapable to me: We should take up and pass reform of the Regulatory Flexibility Act as soon as humanly possible. Senator Bond has a bill on that subject, and the Administration supports reforming Reg Flex. Phil Lader personally played a key role in getting the Administration's endorsement of that step during the National Performance Review. Senator Bond's bill--or similar bills on the House side--could have passed last spring. There is no excuse for not acting. That action would do more than any other legislative step I can imagine to address the serious problem which today's hearing underscores -- Federal agencies simply do not pay enough attention to the needs and problems of small business owners. There absolutely must be a way to enforce their legislative mandates, without at the same time imperiling public health and safety by tilting the regulatory process too far toward business. I look forward to working with the Chairman toward that end.

Chairman BOND. I understand that Mr. LaFalce has other commitments and cannot be with us today, so it gives me very great pleasure to turn to my fellow Missourian and colleague, Congressman Skelton, to present a statement.

OPENING STATEMENT OF THE HONORABLE IKE SKELTON, A REPRESENTATIVE IN CONGRESS FROM MISSOURI

Mr. SKELTON. Thank you very much, Mr. Chairman, and Madam Chair. I compliment both of you for calling this hearing, and I compliment Mr. Glover on his report which, although I have not read it word by word it appears to be a masterpiece. Madam Chair, you mentioned the fact that it has been some two decades since these two Committees have met jointly. I think it is even more remarkable that a Missourian and a Kansan called this hearing today. I think that should go down in the record books as well.

Senator BURNS. The football game has not been played yet, Ike.

Chairman BOND. That is out of order, Senator Burns. We will not mention football today.

[Laughter.]

Mr. SKELTON. Senator Bond, I will speak of basketball though shortly.

The principle finding in this report of the Small Business Office of Advocacy setting forth that small firms bear a disproportionate share of regulatory costs per employee than do large firms. This comes as no great surprise to those of us who serve on the Small Business Committees. We have heard small business owners repeatedly testify about the costs of the regulations. And we have through the years responded to the concerns with legislation, most notably the Regulatory Flexibility Act which I had some of my fingerprints on it back in 1980, and has been amended and strengthened by the House of Representatives earlier this year.

I would like to see this measure pass the Senate. I would like to see it go into effect as soon as possible. And if the advocate's report provides the incentive for even just one of those it will be doing these small business owners a great service.

Since the regulatory burden on business can be attributed to the executive branch as much as to Congress, the President too has addressed this issue by directing Federal agencies to make their regulations and the enforcement process more common sensical and results oriented. Since the advocate's report, however, it does not take into account the efforts of these regulatory changes, perhaps, Mr. Chairman, and Madam Chair, a follow-up study would be in order in a few years concerning that.

I take a moment to commend Mr. Glover and his office for the work of the report. Mr. Glover states this is the first time such a study has been undertaken and its findings certainly provide more food for thought than originally in the idea set forth in the amendment that we put in the House. This study, one simply cannot assume that regulatory relief of any type will de facto help small businesses. Rather, laws, regulations, and enforcement procedures must take small business specifically into account. For many, if not all of us, this is more of a confirmation than revelation. It is most valuable to have this reliable data.

I thank you, Mr. Glover. I thank you, Madam Chair, Senator Bond, for calling this hearing. I think it is extremely timely and well called. Thank you.

Chairman BOND. Thank you very much, Congressman Skelton. Now I would like to call on Mr. Glover to present his testimony. Welcome, Jere.

Senator BURNS. Can I put my statement in?

Chairman BOND. Please. We will accept any statements that you wish to submit for the record.

Senator BURNS. I was going to say, Mr. Chairman, that I fell into the same business, when I went in the auction business, as our colleague from Arkansas. I was not a very good auctioneer when I first started out either, so I had to find other things to do.

Senator BUMPERS. What makes you think it has gotten any better?

[Laughter.]

Chairman BOND. We are glad you found a steady paycheck, Senator Burns.

Senator BURNS. I would just like to put my statement in the record.

Chairman BOND. We will accept your statement.

[The prepared statement of Senator Burns follows:]

PREPARED STATEMENT OF SENATOR CONRAD BURNS
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

Mr. Chairman, this is an issue that continues to plague our small businesses. And until we give them the regulatory relief they need, we will be having these hearings year after year and session after session. Something must be done.

Last week, the White House Conference on Small Business regional delegates celebrated Implementation Day. They were drawing attention to the issues they ranked as very important in their recent conference. I'm sure you are aware that five of their sixty recommendations focused on the need to reduce paperwork and eliminate regulations. The costs to small businesses of all these rules and regulations are truly burying innovation and creativity. We have got to put a stop to it.

As you may know, Mr. Chairman, I recently joined 20 of my colleagues in sending a letter to our Majority Leader to urge him to bring up S.343, the Comprehensive Regulatory Reform Act, before the end of the year. Coupled with our efforts to reduce the budget and give tax relief to Americans, reducing the regulatory burden on small business will improve our economic health.

We have all heard the familiar statistics -- government regulations now cost a typical family nearly $6,000 every year. That's a cost to the U.S. economy of $581 billion each year. With over a hundred agencies issuing regulations, cutting back will be tough...but it must be done.

The Small Business Administration recently eliminated over half of their regulations and they should be applauded. I would be interested to know how they did this and how they would recommend we get other agencies to follow suit.

The EPA Administrator, Carol Browner, said that many of the regulations enforced by her agency "don't make sense." I know a few folks who would agree with her. Likewise, many of the rules and regulations imposed by OSHA are unnecessary and costly. So, let's free up some of the funds that are hard-earned by our small businesses. This will give them more freedom to expand their business, hire more employees, give more benefits, raise wages -- and I don't think anyone can doubt that this would benefit us all.

Mr. Chairman, I thank you for holding this hearing once again. And I think it's notable that we are meeting together with our House counterparts. So often we work separately. Together, we can really make an impact. I welcome them to our distinguished hearing room and I look forward to hearing their input.

Senator BURNS. I, too, have got to go to the same place as Senator Bumpers.

Chairman BOND. All right. As I indicated, when Mr. Glover finishes we will call on members for 5 minutes for opening statements and/or questions.

Mr. Glover.

STATEMENT OF JERE W. GLOVER, CHIEF COUNSEL, OFFICE OF ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

Mr. GLOVER. Thank you, Madam Chair, Chairman Bond, members of the Committees. It is with pleasure that I appear before the Senate and the House Small Business Committees.

Since today is Halloween, I thought it would be appropriate that I come in costume. I thought I would dress up as scary as I could. What scares small business most? You are right, a Government official. So that is what I am here as. I also decided to be fair about this in case there were Government officials here, that I wanted to scare them as well. So I had Barry Pinellas, who has been with the Office of Advocacy for 8 years but is unfortunately leaving, also dress up as the scariest person we could think of for Government officials, and that is Barry Pinellas who has fought tenaciously for small business for many years. Also with me today are Kevin Bromberg and Bob Berney who helped extensively in the preparation of the report.

The theme of today's hearing goes to the core mission of the Office of Advocacy. Congress in 1976 recognized that small business may unduly suffer at the hands of Government regulators and created the office to ensure that the views of small business were heard by Federal policymakers. In 1980, Congress strengthened the hand of the Office of Advocacy by enacting the Regulatory Flexibility Act which requires Federal agencies to examine the burden their regulation places on small business, and if those burdens are significant, seek alternatives that will minimize that burden on small business.

Since 1980, I think it is fair to say that previous chief counsels and both the Senate and House Small Business Committees have been diligent in their oversight and implementation of the Regulatory Flexibility Act. Congress has directed that the Office of Advocacy examine the impacts of tax paperwork and other regulatory burdens on small business and I am here today to report those findings.

Before I discuss those findings, which have been presented in a somewhat academic fashion, I want to discuss the realities of small business. I think one of the things that Congress did best when they created the office of chief counsel was require that that individual come from the private sector so that person would have real life experience in small business.

The one thing that small business fears most really is Government regulations. There are 130,000 pages of Government regulations. Without exception, every small business is in fear that 1 day an inspector will walk into their business, look at the facility, find in one of those 130,000 pages, a violation, fine that small business and the small business owner will then end up losing everything

they have put their life into. That is a very real fear that we hear from small business owners.

Small business owners know they are not only the CEO, they are the safety officer, they are the compliance officer, they are the labor relations officer, and they are the accountant. They have everything to do, and very few resources to do all these things. They know all those regulations exist and they know that they could be in serious trouble for violations.

One of the things that I feel proudest about is that the SBA made a strong recommendation to the President which he adopted, to change the Government's enforcement policy as it affects small business. The idea that small businesses would not be subject to "gotcha" as they have been in the past, the fact that good faith would be considered, that fines could be waived by agencies, all will go to help remove that perception. But that perception is longstanding and based on many years of Government enforcement, and it is certainly still in the marketplace now. We need to make sure that that perception is, over time, eroded.

While many economists and legislative and policy analysts, and certainly Members of Congress have decried the adverse and disproportionate impact of regulation on small business, no comprehensive study had existed prior to this study to test that premise. My office welcomed the opportunity of this congressionally mandated study to perform a study which has demonstrated the veracity of this principle. Since 1980, the Office of Advocacy has undertaken over 30 different studies on the regulatory burdens of various sectors of the small business community.

The Office of Advocacy in doing this study took three different tacks. First, we did an exhaustive review of the current economic and policy analysis literature to find studies that examined the impact of regulations on small business, and particularly on businesses in general.

Second, we contracted with Professor Thomas Hopkins at Rochester Institute of Technology, a leading researcher in the field of quantifying the impacts of regulations on business, and especially small business. Unfortunately, he is in Czechoslovakia and will not return for a couple of weeks and he is not able to be here today.

Finally, the Office of Advocacy undertook its own analysis of the literature and findings prepared by Dr. Hopkins to reach its own conclusions concerning the impacts of regulation on small business.

I always like to find good news whenever possible and if you look at the first chart, figure 4, what you see is that as a percentage of the gross domestic product the regulatory burden has leveled off, and it is basically remaining at current levels. I think that is the first set of good news.

Now if we look at the next chart, Dr. Hopkins accumulated information based on social and economic regulatory costs, those costs directly arising, for example, the addition of pollution abatement equipment in a manufacturing facility and the process cost, to calculate the total cost of regulation compliance.

Now again on the good news side two regulatory costs have actually gone down over the last couple of decades: the economic transfer cost and the economic efficiency cost. The economic efficiency cost is, for example, deregulation of transportation where the Civil

Aeronautics Board used to exist and regulate the airlines, also the Interstate Commerce Commission regulated the cost of freighting, trucking and buses. Those regulatory costs have come down.

Senator BUMPERS. Mr. Glover, are you talking about small business regulatory costs or all regulatory costs?

Mr. GLOVER. At this stage we are talking all regulatory costs. We are going through the general analysis. The transfer costs are things like export trade assistance and facilities, things like agricultural programs which we shift the burden between various sectors of the economy. Both of those sectors as well have gone down.

That basically ends the good news and then we start with the bad news. If you look the biggest jump up in burden has been, in environmental regulations and that is quite obvious. The next area is process regulation which has also seen a major jump up. Process regulation sector is basically paperwork, and the biggest part of that is the Internal Revenue Service and the payroll and Social Security records. We have seen a rather dramatic increase in both of those areas. Other social regulation costs such as OSHA, other worker safety areas and things like that have not really gone up that dramatically.

Chairwoman MEYERS. Mr. Glover, could you clarify again the economic transfer and economic efficiency costs?

Mr. GLOVER. I will try. They are academic terms but I will do my best to explain those. The transfer cost is moving something from one sector of the economy to the other. The example used most often is restrictions on importation of sugar. That transfers cost from the sugar producer which has a higher price to the consumers and the small business people which have to bear those higher costs. So there's an economic shift of cost in those situations.

Likewise, most of the agricultural programs are there. But the biggest majority is in export trading situations where we had barriers to entry, we have tariffs, we have restrictions on supply. As we have gone to a more free trade society, those have come down rather noticeably.

The efficiency cost is where the Government did something to interfere with the efficient operation of the marketplace. Specifically, we regulated the airline industry. We set their rates for 40–50 years, and almost 20 years ago we started deregulating the airline industry and their rates are completely deregulated today. So we basically have gotten the Government out of that business. Likewise, we no longer set railroad or freight rates, we no longer set the trucker's rates, and we no longer set bus rates. So those are the two different areas that I think are explained there.

Chairwoman MEYERS. Thank you.

Mr. GLOVER. After identifying the general areas of economic and regulatory cost, Dr. Hopkins then went on to develop the total cost numbers. For that number he came up with a figure of $649 billion; a similar number to those he has used in previous studies.

Now those charts show you where those various trend lines have been going. The next thing that Professor Hopkins did for us was he split the regulatory burden between consumers and business. About 60 percent of the regulatory burden falls on business. So we

first identified what proportion of that large number, $650 billion for round numbers, was for all business.

So once we found that number, we then took it and went into various industry sectors. If you look at the next figure what you see is that manufacturing—and it probably does not come as a surprise to anyone—has a disproportionate burden of the cost of regulations. The other sectors we say are not as bad, we still talk about $100 billion. It is a fairly significant amount that the retail sector has as well as the service sector and other industries as well. We see costs are distributed amongst the various industries.

Once Professor Hopkins looked at all business, we then looked at the issue of what are the costs for small business. We looked at industry sectors and determined small business' share of those industry sectors and allocated the cost between the various small and large business sectors. I have one chart which we will hand out to you which we do not have in a big one. If you will look at that chart you will see the results of the conclusions that we reached.

What we found was that the average cost per employee of regulations was $5,100. Now that is for under 20 employees. If you look at the 20 to 499 category, that number drops down to $4,950. And if you look to the over 500, those costs drop down to $3,400.

Now we also looked, because there is a lot of controversy as to whether transfer costs—because they do not affect the gross domestic product and merely shift resources between various sectors of the economy, various sectors of the industry—should be included. So we provided the information without transfer cost included. The same relationship still exists.

We also wanted to look at the cost per dollar of sales. We thought that was an important factor to look at as well. We again find the same disproportionate burden on small businesses in that category. That is the table on the right. For small businesses, firms with less than 20 employees, the cost is 4 cents per dollar of sale; for the mid-size firms you are talking 20 to 499, 3.8 cents; and of course, for the firms with over 500 employees that number drops down to 2.1 cents. Without the transfer cost it is about one-third less than that. So I think that what we see throughout our analysis and throughout the industry sectors is that this is the case.

Now we also did an exhaustive analysis of literature which we discuss in our report and similar numbers have been found even in narrow segments, where we looked at the burden of environmental regulations. We looked at other factors, and we found the same trends occurring in other studies. So we were feeling very comfortable that the conclusion is very strong that there is a very clear disproportionate burden that is placed on small business and that continues despite the passage of the Regulatory Flexibility Act.

Now we did make an adjustment to Professor Hopkins' study. Professor Hopkins' study found that one-third of the businesses that reported said there was little or no regulatory burden on small business. So we adjusted his numbers down slightly. But whether you use our numbers or his numbers, which are slightly higher, we used a 1.5 to 1 ratio, he used a 1.8 to 1 ratio, the conclusion is inescapable and that is that small business does carry a very heavy

burden and that burden is the one that has not gotten better over time.

There have been a lot of activities undertaken in the last year or two which we do not include in our report because we are not able to quantify those yet. Let me just mention briefly the effects of those. The administration has taken a two-pronged approach to reform the Government process. The National Performance Review has undertaken major efforts such as rationalization of Federal regulations, reductions in the total number of pages, eliminating some 16,000 pages and rewriting over 25,000 pages of Federal regulations.

The Office of Management and Budget has instituted a process designed to ensure appropriate examinations of the rules under Executive Order. We have worked with OMB. We now have a memorandum of understanding where they share regulations with us, as well. The President has ordered that the agencies change the way they enforce their rules and regulations.

Congress has also shown an interest in regulatory relief by enacting the Paperwork Reduction Act, which requires the agencies to reduce their paperwork burden 10 percent per year for each of the next 2 years and 5 percent thereafter. We have also seen the limitations placed on unfunded mandates, which will go a long way toward reducing those burdens as well.

These efforts are significant, but not sufficient in my estimation, to reduce the disparite burden on small businesses. Absent judicial review of compliance, with the Regulatory Flexibility Act, agencies will continue to overlook significant and important small business considerations. Enactment of judicial review will go a long way toward ensuring that small businesses are not some regulatory afterthought.

I cannot state strongly enough that Federal agencies cannot reduce the burden single-handedly. Congress itself needs to be more sensitive to the burdens on small business when it enacts legislation.

In 1989, before the Senate Small Business Committee held a hearing on the need for reform, the Regulatory Flexibility Act, John Satagaj, head of the Small Business Legislative Council, suggested that Congress make the Regulatory Flexibility Act applicable to its own legislative actions. That was a good idea then, and it remains a good idea today.

Thank you very much, and I will be happy to answer any questions.

[The prepared statement and attachments of Mr. Glover follow:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

Testimony of

Jere W. Glover

Chief Counsel for Advocacy

of United States Small Business Administration

Before the

Committees on Small Business

of the United States Senate

and

House of Representatives

October 31, 1995

Good morning, Mr. Chairman and Madam Chairman: This hearing is an auspicious occasion -- the first time the Senate and House Small Business Committees have held a joint hearing at which the Chief Counsel for Advocacy has testified.[1] I would like to thank the Committees for their interest in today's topic -- the impact of regulation on small business. With me today is Barry Pineles, the Assistant Chief Counsel for Market Competition who will be leaving the Office of Advocacy after eight years of dedicated service to the small business community.

The theme of today's hearing goes to the core mission of the Office of Advocacy. Congress, in 1976, recognized that small businesses may unduly suffer at the hands of government regulators and created the Office to ensure that the views of small businesses were heard by federal policymakers.

In 1980, Congress strengthened the hand of the Office of Advocacy by enacting the Regulatory Flexibility Act (RFA) which requires federal agencies to examine the impact of their regulations on small business, and if they are significant, examine alternatives that will minimize the burdens or enhance the benefits of such regulation. Since 1980, both the House and Senate Small Business Committees have been diligent in their oversight of implementation of the RFA. Despite Congressional pressure from both the House and Senate Committees and strong statements from President Clinton, I

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[1] The opinions in this testimony are mine and do not necessarily represent the views of the Administration.

am not satisfied with agency compliance with the RFA. It may be that federal agencies still do not understand the impact that their regulatory efforts have on small businesses.

Congress enacted legislation which it hoped would demonstrate in no uncertain terms that small businesses face disproportionate burdens in complying with federal regulations. Congress mandated that the Office of Advocacy examine the impact of tax, paperwork, and other regulatory requirements on small business. I am here today to report on those findings.

Those findings tell only one aspect of the story and tell it in a statistical and somewhat clinical fashion. In reality, the fears of small business go far beyond the somewhat detached discussion we will have today. Everyday, small business men and women fear that some inspector or IRS auditor will walk through the front door, find them in violation of one of the 120,000 pages of federal regulations, and bankrupt the business that consumed most of their life savings. It is not surprising then that the reform of regulatory and enforcement policies is of paramount importance to the delegates at the recent White House Conference on Small Business. That is also why I am pleased that the President adopted an SBA idea to direct government agencies, particularly EPA and OSHA, to provide greater assistance to small business rather than simply seek to impose fines, especially on first violations.

Federal agencies are not the only ones that impose burdens on small business. Often federal agencies are implementing statutory directives enacted by Congress. Congress, in debating various legislative proposals, must take into account the burdens that the proposals will have on small business as well as their impact on the overall economy.

It would be my fondest wish to say that the Office of Advocacy has done its job so well that it is no longer needed. Unfortunately, our research, as I will discuss shortly, shows the federal government has a long way to go before the role of the Office of Advocacy becomes obsolete. I do, however, expect that the findings released today will provide the information that Congress and federal regulators can use to develop public policies sensitive to the needs of small business. The study also should be an impetus to federal agencies to conduct further empirical research on the disparate impact of proposed regulations during individual rulemaking proceedings.

I. *The Study*

While many economists, legislators, policy analysts, and, most significantly, small business owners, have decried the adverse and disproportionate impact, no comprehensive study existed which confirmed that premise. My office welcomed the opportunity of the

Congressionally mandated study to perform a study which would beyond cavil demonstrate the veracity of this principle.

The Office of Advocacy has been the prime sponsor of research that analyzes the differential impact of regulations on small business. One of the first studies undertaken by the Office was a study of compliance costs by the Batelle Human Affairs Research Centers in 1980 which found that small businesses in the State of Washington with fewer than 50 employees bore a disproportionate cost burden from regulation compared with businesses in the 50-500 employee category. Since that seminal Batelle study, the Office of Advocacy has sponsored two other studies, both completed in the mid-1980's which reconfirmed the findings of the Batelle researchers. However, the latter studies did not examine the vast gamut of regulation and the Batelle study did not analyze the regulatory burdens of all small firms, including those with up to 500 employees, in comparison to the regulatory burdens faced by large firms.

The Office of Advocacy compiled this report by following three tracks. First, it exhaustively reviewed the current economic and policy analysis literature to find studies that examined the impact of regulation on business, and particularly small business. Second, it contracted with Dr. Thomas Hopkins of the Rochester Institute of Technology, a leading researcher in the field of quantifying the impacts of regulation on all businesses, and

especially small businesses. Finally, the Office of Advocacy undertook its own analysis of the literature and the findings by Dr. Hopkins to reach its own conclusions concerning the impact of regulatory burdens on small businesses.

There are a number of studies demonstrating that the imposition of regulations affect the economy and may even retard its growth. However, that statement alone does not imply necessarily that all regulation is bad. Since the cost of most regulation is absorbed in the short or intermediate-run, the economic impact generally is felt immediately. On the other hand, regulations may have long-run or even intangible benefits which are much harder to quantify. Nevertheless, it is important for both Congress and agencies to understand the true costs imposed by regulation.

Dr. Hopkins accumulated data on social and economic regulatory costs (those costs directly arising from, for example, the addition of pollution abatement equipment on a manufacturing facility), and process costs[2] to calculate the total cost of regulatory compliance. Dr. Hopkins found that total costs in 1994 for complying with regulations was about $649 billion or approximately 10 percent of the Gross Domestic Product.[3]

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[2] Process costs come from paperwork required because of government process, such as tax compliance, recordkeeping mandates, and completion of health care reimbursement forms.

[3] As Everett Dirksen once noted "a billion here, a billion there, and pretty soon you're talking about real money." The late
(continued...)

Dr. Hopkins then allocated these regulatory costs across business sectors. To perform this calculation, Dr. Hopkins first factored out the costs of regulation borne by states, local governments, and consumers.[4] Businesses incur more than 60% of the $649 billion costs for regulatory compliance. Since there is no statistically precise method (such as linear programming, multivariate factor analysis or multiple regression) of allocating costs among various sectors, Dr. Hopkins used his best judgment for dividing those costs among manufacturing, trade, services, and other businesses. It is not surprising to find that the majority of costs are borne by manufacturers (since they absorb the overwhelming amount of environmental regulations). Nevertheless, other sectors of the economy face substantial burdens in complying with regulations.

While these data are important, total regulatory costs are not the primary interest of my office or the small business committees -- costs on small businesses are. The Office of Advocacy requested Dr. Hopkins to take his data and parse it for firm size. The exact methodology is discussed in the report and I will not overwhelm the committees with further elaboration. Suffice it to say that Dr.

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[3](...continued)
Senator would certainly concur that, when it comes to regulatory costs, we're talking about real money. In fact, the United States economy is so large that money spent on regulatory compliance exceeds the gross domestic product of all but four countries in the world -- Japan, Germany, France, and the United Kingdom.

[4] Although it is too early to report, the enactment of unfunded mandates legislation this year should have a palliative effect on the regulatory burdens faced by state and local governments.

Hopkins arrived at a cost of regulation per employee and developed a multiplier to figure the per employee cost based on three firm size divisions: less than 20 employees, 20-499 employees, and 500 or more employees. Hopkins then calculated the per employee cost for manufacturing and service industries.

Dr. Hopkins' results confirm the previous studies commissioned by the Office of Advocacy. Regulatory costs per employee are substantially greater for businesses with fewer than 500 employees than for those that exceed 500. Dr. Hopkins further discovered, in a not surprising result, that regulatory costs per employee for manufacturing is nearly double the average cost per worker in the rest of the economy. Dr. Hopkins also found that service firms with more than 500 employees experience significantly lower costs per employee than smaller service firms.

Of particular significance was Dr. Hopkins' evaluation of the differential burdens imposed by the process of collecting taxes (as opposed to the actual tax burden) on small firms. The Office of Advocacy has received much anecdotal evidence of the problems facing small business in staying current with changes in tax regulation and the costs associated with tax compliance. Dr. Hopkins confirmed that tax compliance and recordkeeping are the two largest components of regulatory burden facing small business. This burden is even more troubling in that small businesses often do not have the resources to hire accounting, payroll, and other

tax specialists to handle compliance. Senior managers must divert themselves from the actual operations of the business to ensure compliance with tax laws. Can one imagine the Chief Executive Officer of General Motors checking to see whether a payroll tax deposit has been made? The owners of small businesses do it regularly. It amazes me that small business owners actually have time to run their businesses given the various burdens they face.

The Office of Advocacy does not dispute the fundamentals of Dr. Hopkins's study. However, the Office believes that Dr. Hopkins may have overstated the cost difference between the largest and smallest firms because he did not consider the fact that one-third of the firms surveyed indicated no or only minor regulatory burdens. An explication of our disagreement with Dr. Hopkins is contained in the report. Nevertheless, whether one decides to utilize the 80% differential calculated by Dr. Hopkins or the 50% differential estimated by the Office of Advocacy, one conclusion is beyond dispute -- small businesses bear a disproportionate share of this nation's annual regulatory bill.

The information contained in the report is not only grist for the mill of academia. It has real world implications. First, it puts to rest the canard that small businesses do not face disproportionate regulatory costs. Second, if small businesses are the most significant sector of the American economy, both in total number of firms and in job creation and innovation, then the

disproportionate regulatory burdens absorbed by these small businesses acts as a brake on a powerful economic engine. If the economy is going to put the pedal to the metal so to speak, then something must be done to release the brake that regulation is imposing on small business.

II. *The Current Efforts*

The Clinton Administration came to Washington and within weeks of taking office, the President appointed Vice President Gore to head a task force to reinvent the government. Although the primary goal of that National Performance Review was to streamline the government and make it more efficient, it had a corollary objective -- to reduce regulatory burdens on all businesses, in particular on small businesses. That first effort achieved some real reductions in eliminating some regulatory and paperwork requirements. For example, the Small Business Administration substantially decreased the size of its guaranteed loan application. Was this effort important? Yes. Was this effort sufficient? In my estimation -- NO!

The Administration also recognized that the National Performance Review could not cut the costs without modifying the procedures that agencies use to promulgate regulations. Shortly after the release of the National Performance Review report, the President, as have previous Presidents, issued an Executive Order (12,866)

which required agencies to select the regulatory method that maximizes net benefits to the public (unless prohibited by statute), requires a cost/benefit analysis, and represents the most cost-effective method of achieving its regulatory objectives. In theory the Executive Order is fine, but in the real world of regulatory decisionmaking, many rules that may be important to small business are excluded from that review because they do not meet the Order's threshold. In addition, independent regulatory agencies, such as the FCC, are not covered by the Order. Is this effort important? Yes. Is this effort sufficient? In my estimation -- NO!

One idea that had been brought to the attention of both the Administrator of the SBA and myself was that some federal agencies employed overly zealous inspectors more interested in giving fines than ensuring small businesses complied with the regulations. Instead of issuing fines, these businesses suggested that the agencies provide compliance assistance to the small business rather than simply issuing fines. The Administration adopted that proposal and now, instead of an OSHA inspector issuing a fine to a small business for a missing safety poster, he gives the business owner a copy of the poster. The enforcement policy also allows agencies to reduce or eliminate fines on small businesses if the business comes into compliance. Is this effort important? Unquestionably! Is this effort sufficient? In my estimation -- NO!

The Administration also recognized that changing the review process for future regulations would do nothing about the thousands of regulations currently in force and burdening small business. The President, on February 21, 1995, initiated Phase II of the National Performance Review by directing all federal agencies (independent agencies have voluntarily decided to comply), to conduct a page-by-page review of all regulations and to eliminate or modify those that need reform. It cannot be denied that this ongoing effort will eliminate or modify numerous regulations. For example, the Small Business Administration is planning to cut the number of its regulations in half. The Food and Drug Administration plans to eliminate many of its food identity standards including that all important definition of grits. Unfortunately, some agencies may believe that certain regulations are vital that others do not. Is this effort important? Yes. Is this effort sufficient? In my estimation -- NO!

This Congress also has made efforts to reduce the regulatory burdens on business and governments. It passed and the President signed legislation limiting the imposition of unfunded mandates on state and local governments. Legislation also was enacted that amended the Paperwork Reduction Act which gave the Office of Management and Budget even more power to eliminate unnecessary and overly burdensome paperwork and information collection requirements. Finally, Congress is considering a raft of legislation to reform the regulatory process. Included in the

bills are requirements for cost-benefit analysis, reviewing of regulations, risk assessments, and other requirements designed to ensure an agency has analyzed the problem and potential solutions. Are these efforts important? Yes. Are these efforts sufficient? In my estimation -- NO!

All of these general solutions have an inherent flaw. They do not directly address the basic finding of this report --- that small businesses are disproportionately burdened by federal regulation in comparison to their large business competitors. Except for the specific regulatory reform efforts of the SBA and the change in enforcement policy at agencies such as OSHA and EPA, the current efforts are aimed at reducing regulatory burdens in general and not specifically on small business. While the expectation that eliminating regulations will benefit all businesses, including small ones, there is no such guarantee. For example, federal regulations which would eliminate airbags or other passive restraints in automobiles would have little impact on small business. On the other hand, raising the dollar threshold from $25 to $75 for providing documentary proof for the deduction of business related meals and entertainment expenses will provide a substantial reduction in the burden imposed on small business. Regulatory reform without focus is likely to result in the Office of Advocacy doing another study 15 years from now and finding the exact same result -- small businesses are disproportionately burdened by government regulation. Until the concerns of small

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business become paramount in the mindset of federal policymakers, it will be impossible to eliminate the disparate impact on small businesses.

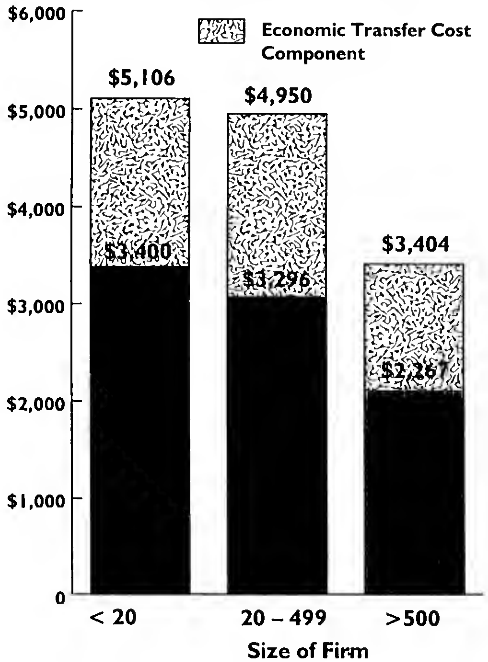
III. *The Necessary Solution*

An act currently exists which is designed to inculcate concerns of small business into the regulatory process -- the RFA. Unfortunately as I and previous Chief Counsels have documented in annual reports and in testimony before both committees, compliance with the RFA is inadequate. Agencies, such as the Internal Revenue Service, the Department of Agriculture (with the Forest Service and Agricultural Marketing Service being especially egregious violators), and the Department of Interior, can ignore the RFA. The only way to ensure that all agencies comply with the RFA, and therefore consider the impact of their regulatory proposals on small business is to modify the RFA so that agency compliance can be tested in court. No longer would an agency be able to certify a proposed rule and avoid consideration of small business impacts entirely. If the agencies fear judicial review, it is because they have been doing an inadequate job in considering the impacts on small business and devising alternatives that will achieve their statutory objectives without imposing the disproportionate impact on small business found by our study. Agencies that comply with the law should have no fears. Until that time, it will remain open season on small business.

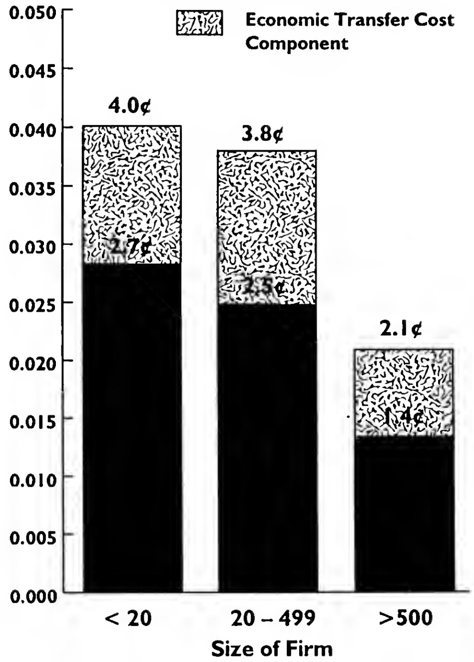
I cannot state strongly enough that federal agencies cannot reduce these burdens single-handedly. Congress, itself, needs to be more sensitive to the burdens on small business when it enacts legislation. In 1989, the Senate Small Business Committee held a hearing on the need for reformation of the RFA and John Satagaj, the head of the Small Business Legislative Council, suggested that Congress make the RFA applicable to its legislative actions. That was a good idea then and remains a good idea today.

Thank you for your attention today. I am willing to answer any questions the committees' members may have.

Average Regulatory Costs per Employee, by Size of Firm



Average Regulatory Costs per Dollar of Sales, by Size of Firm



Source: U.S. Small Business Administration, Office of Advocacy.

SBA U.S. Small Business Administration
Office of Advocacy

October 1995

The Changing Burden of Regulation, Paperwork, and Tax Compliance on Small Business: A Report to Congress

Contents

The Changing Burden of Regulation, Paperwork, and Tax Compliance on Small Business

Introduction

When small business owners get together at events like the White House Conference on Small Business, the problem of complying with regulations and dealing with regulators is always a major topic of conversation. The paperwork burden of the Internal Revenue Service (IRS) is the primary concern because preparing a regular payroll is a constant reminder of the numerous rules and regulations dealing with tax withholding and reporting.

But businesses' concerns are not limited solely to paperwork issues. Small business owners often fear that they will inadvertently fail to comply with some obscure rule, and that a government inspector will show up, close down the business, and drive them into bankruptcy. Many believe, with some justification, that the government is more interested in obtaining penalties than in promoting compliance with the law. The recent efforts to make the government more customer-friendly, while important and dramatic, have not yet changed this longstanding perception.

When leading thinkers on small business issues assembled late in 1994 under the aegis of the White House Conference to discuss barriers to entry for small businesses, all 15 focus groups cited the burdens of regulations, paperwork, and taxpayer compliance.

Because of the widespread interest in this issue, the Congress requested that the chief counsel for advocacy complete a "study of the impact of all Federal regulatory, paperwork and tax requirements upon small business..."[1] This Office of Advocacy report is based on

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[1]P.L. 103-403, Section 613.

some earlier landmark research, current research[2] initiated by the office and a review of the current regulatory developments.

The importance of maintaining a viable, dynamic, and progressive role for small businesses in the American economy is beyond dispute. The nation's traditional values of individual initiative, social mobility, and political freedom are dependent on the free enterprise system which, in turn, depends upon the competition provided by a large and healthy community of small firms. Policies that encourage a growing small business sector will also ensure, as research has shown, increasing job opportunities, a continuous flow of innovations, more vigorous competition, and an ever-increasing standard of living.

This report addresses the burden of regulation, paperwork, and tax requirements, how that burden affects the cost structure of small firms relative to large firms, and, ultimately, how it may affect their profitability. It is the regulatory impact on the cost structure of a firm that makes regulation a major concern for small business owners.

Three questions need to be addressed:

1) Does the burden of regulation fall more heavily on small firms?

2) If so, is it good public policy to regulate in such a way as to give large firms a competitive cost advantage in the marketplace?

3) If the answer is no, how can the regulatory process be changed to help achieve a level playing field?

Before addressing these questions, it is important to note that this report does not

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[2]Thomas D. Hopkins, *Profiles of Regulatory Costs*, research prepared for the U.S. Small Business Administration, Office of Advocacy, under contract no. SBAHQ-95-M-0298, forthcoming.

attempt to measure the benefits of regulation, nor to allocate the benefits by firm size. First and foremost, comprehensive research estimating benefits is not available. Second, it is nearly impossible to allocate benefits among the affected persons and businesses.

Benefits are distributed throughout society as a whole. Clean water, for example, benefits the food processing, dairy, and outdoor recreation industries, among others. But the costs are concentrated on those being regulated--in this example, on the firms that must find alternatives to discharging pollutants into the waterways. Such firms may or may not derive direct benefits from clean water regulations to offset their compliance costs. Thus, it is extremely difficult either to estimate total benefits or to allocate those benefits among the affected sectors of society.

Last, irrespective of the benefits of a given regulation, the knowledge of the existence of a disproportionate cost impact on smaller firms is important to policymakers. The size, nature, and trends of the disproportionate effect should dictate different policy responses by decisionmakers (e.g. strengthening the Regulatory Flexibility Act or providing more compliance assistance to small firms).

This report, the first of its kind, focuses on measuring total regulatory costs, identifying how they are allocated among small and large firms, and discerning whether the regulatory environment is unnecessarily impeding the birth and growth of small businesses.

Finally, the report discusses initiatives taken by the Clinton Administration and the Congress to reduce the cost of regulation. Executive Order 12866 establishes a review process for all significant regulations to ensure that rules are cost-effective and minimize small business burdens. Certain cabinet agencies are revising their enforcement policies to

emphasize compliance, rather than the imposition and recovery of penalties. The Paperwork Reduction Act (PRA)[3] and the Regulatory Flexibility Act (RFA)[4] require agencies to review the impact of their regulations on small businesses and consider less costly alternatives for accomplishing public policy objectives.

The report does not, however, factor in the cost savings generated by these initiatives, largely because the data are not available and because the savings are diffused throughout the economy. Also, some of the initiatives are too new to have had any concrete impact on small businesses. As a consequence, the perception persists among small firms that the regulatory burden is ever-increasing.

The perception is not totally inaccurate: the aggregate regulatory burden is still increasing. However, the relative burden, compared with the size of the economy, has been reasonably constant in recent years. In other words, the amount of regulation is growing at the same rate as the overall economy. The significant issue is how these costs are divided among firms of different sizes that compete with one another.

The Office of Advocacy funded research to address this issue and outlined the research parameters to be followed by the contractor. This research and other available data lead to the conclusion that the average annual cost of regulation, paperwork, and tax compliance for firms with fewer than 500 employees is about $5,000 per employee, compared with about

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[3]P. L. 96-51.

[4]P.L. 96-354.

$3,400 per employee for firms with more than 500 employees.[5] While the total burden on a firm increases with firm size, the burden per employee or per dollar of sales decreases with firm size.

Thus, the answer to the first question, whether the regulatory burden falls more heavily on small firms, is yes: the regulatory cost per employee to small firms is approximately 50 percent more than the cost to large firms. Small businesses employ 53 percent of the work force, but shoulder 63 percent of the total business regulatory costs.

This inequitable cost allocation gives large firms a competitive advantage, a result at odds with the national interest in maintaining a viable, dynamic, and progressive role for small businesses in the American economy. It appears then that the answer to the second question is that an inequitable allocation of regulatory costs is not good public policy.

As for the third question—how the regulatory process can be improved—the finding further suggests that, despite more than 13 years' experience with the Regulatory Flexibility Act, public policy makers need additional direction to reconcile their regulatory decisions with the national goal of preserving competition through the growth of small business. The need for regulatory reform through initiatives such as amending the RFA is great.

In support of these findings, the Office of Advocacy submits the following report to Congress, which is organized as follows: Section I reviews recent revisions in the regulatory process affecting small firms. Section II proffers the theory and empirical evidence of

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[5]These figures are estimates for 1992, based on many assumptions, including assumptions about the business share of total regulatory costs, the industry sector shares of the business costs, and employee wages. These assumptions were needed in the absence of hard information. In sum, these estimates are subject to some uncertainty.

disparate burdens on different sizes of business caused by regulation. Section III reviews tax-related paperwork burdens. Section IV addresses the total cost of regulation. Section V reviews the literature on benefits. Section VI allocates the cost of regulation by industry and firm size. The final section develops the Office of Advocacy's conclusions and discusses the future of regulation.

I. Changing the Regulatory Process for Small Firms

President Clinton is committed to reinventing the federal regulatory process and reducing the burden of government on small firms. He initiated the Small Business Forum on Regulatory Reform, which brought together small businesses and federal agencies to formulate new solutions to help make regulations more cost-effective. The president directed federal departments to cut in half the frequency with which firms must file most reports (for example, quarterly reports will be due only semi-annually). Agencies are redoubling their efforts to focus on results, not red tape.

Executive Order 12866

On September 30, 1993, President Clinton initiated the administration's efforts to ease the regulatory burden on small firms by issuing Executive Order 12866, "Regulatory Planning and Review." This order requires federal agencies to analyze carefully their major regulatory undertakings and to take action to ensure that these regulations achieve the desired results with a minimum societal burden. A major objective of this executive order is to reduce the disproportionate share of the federal regulatory burden that falls on small

businesses. Under the executive order:

(1) each agency must choose the approach that maximizes net benefits, unless the statute requires another regulatory approach;

(2) each agency should assess the costs and benefits of regulatory alternatives, including the alternative of no regulation; and

(3) each agency must tailor its regulations to impose the least burden on society, including businesses of different sizes, consistent with achieving the regulatory objectives.

Each "economically significant regulatory action" is to be accompanied by a formal regulatory analysis that includes an assessment of the potential costs and benefits of each regulatory alternative. Under the current Regulatory Flexibility Act, an analysis of regulatory alternatives minimizing the impacts on small businesses is required if there is likely to be a "significant economic impact on a substantial number of small entities."[6] Implementation of the principles of the RFA has saved hundreds of millions of dollars annually for small businesses in Environmental Protection Agency (EPA) rulemakings alone.[7]

Executive Order 12866 requires that significant regulations and the accompanying analyses be reviewed by the Office of Management and Budget (OMB) for compliance. The OMB has agreed to work with the Office of Advocacy regarding agency noncompliance with the Regulatory Flexibility Act.

The vice president is the president's principal regulatory advisor. A senior-level

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[6]P. L. 96-354, Section 605.

[7]U.S. Small Business Administration, Office of Advocacy, *Selected Accomplishments of the Office of Advocacy, Overview of the Office of Advocacy* (Washington, D.C.: U.S. Small Business Administration, July 21, 1995).

interagency regulatory working group has been established to promote the development of regulations consistent with the president's priorities and to minimize regulatory inconsistency and duplication among the various agencies. Each agency also develops an annual regulatory plan that describes the agency's most significant regulatory actions for the next fiscal year.

Reinventing Government

The National Performance Review (NPR), carried out by the Office of the Vice President, required a comprehensive review of all governmental functions in the first year of the Clinton Administration, and included substantial scrutiny of the regulatory process. The following are among the regulatory recommendations: (1) encourage more innovative approaches to regulations, (2) encourage consensus-based rulemaking, (3) enhance public participation in rulemaking, and (4) streamline agency rulemaking procedures. One important NPR recommendation advises federal agencies to include an inquiry about business size in all business surveys to ensure that policymakers making decisions affecting small businesses have adequate data. The regulatory component of the NPR reinforces the principles of Executive Order 12866.

On February 25, 1995, President Clinton initiated Phase II of the National Performance Review by directing all federal agencies to conduct a page-by-page review of all regulations and to eliminate or modify those regulations in need of reform. The president also directed the agencies to identify more opportunities for consensual rulemakings and to improve the management of federal regulatory programs.

The overhaul of the small business penalty policy, announced a month later, is an

especially important part of regulatory reform. Agencies were ordered to waive up to 100 percent of any punitive penalty for any small firm that attempts in good faith to comply with regulations and corrects a violation within a reasonable time. If there is a penalty of any kind, the small business may be permitted to use the money to fix the problem, rather than paying a fine to the government. This policy marks a substantial change for the enforcement programs, which have traditionally been penalty-oriented, rather than compliance-oriented.

At the White House Conference on Small Business, President Clinton announced the preliminary results of the administration's recent regulatory review of existing regulations. More than 16,000 pages are being eliminated from the *Code of Federal Regulations*, including 50 percent of the Small Business Administration rules and 40 percent of the Department of Education rules. Another 31,000 pages are being modified. A 25-percent reduction in the Environmental Protection Agency's paperwork burden was also targeted for action.

Congressional Regulatory Reform Efforts

The legislative centerpiece for small business regulatory reform has been, and remains, the Regulatory Flexibility Act of 1980. This study confirms the RFA's original premise, namely that small firms suffer a disproportionate impact from federal regulations. It is still true today. Pending legislation to amend the RFA is of key interest to small businesses. For many years, small business trade groups have sought to strengthen the RFA by permitting judicial review of agency compliance with the act. H.R. 9, the Job Creation and Wage Enhancement Act of 1995, passed by the House of Representatives, would permit

judicial review for up to one year after enactment of the final rule.[8]

The Paperwork Reduction Act was also reauthorized in 1995. The PRA establishes a process to control the proliferation of paperwork and recordkeeping requirements and was designed, in part, to help small businesses. Originally passed in 1980, the law gives the Office of Management and Budget the authority to approve all federal paperwork and recordkeeping requirements, even those of the independent agencies not subject to Executive Order 12866.

The PRA reauthorization legislation strengthens the 1980 act and requires federal agencies to reduce their paperwork requirements by 10 percent per year in 1996 and 1997, and by 5 percent each year thereafter. The new law also extends PRA coverage to include federal agency disclosure requirements and information required to be disclosed to third parties (for example, manufacturers of hazardous chemicals must provide material safety data sheets to chemical purchasers). This significant change sought by small businesses overturns a 1990 Supreme Court decision that had negatively affected millions of small businesses. This summer, OMB issued its final regulations implementing the reauthorized Paperwork Reduction Act.

Congress also has shown great interest in other legislation promoting regulatory reform and paperwork reduction. H.R. 9, for example, contains various elements of regulatory reform addressing risk assessment, cost/benefit analysis, and regulatory flexibility for small businesses. The legislation would also require the use of outside peer review groups

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[8]The Senate and the president have also endorsed judicial review of the Regulatory Flexibility Act, but the Senate has not yet acted on this matter in this session.

to help ensure that the analyses are objective and unbiased.[9] The merit of some of these reform provisions is subject to considerable debate.

Clearly, this administration and Congress plan to reduce not only the aggregate burden on small firms, but also regulation of all businesses. However, several obstacles to curbing the rising cost of regulations remain. First, there is a backlog of federal regulatory requirements that are required to be issued now and into the future. For example, the 1990 Amendments to the Clean Air Act require EPA to promulgate dozens of rules, well beyond the year 2000, causing clean air costs to continue to rise at least through the year 2005. Second, new legislation frequently requires the issuance of more regulations. Third, even the demand for the clarification of old regulatory requirements generates new rules to be read and understood.

The 1995 White House Conference on Small Business

In 1994 and 1995, more than 20,000 small business leaders participated in more than 50 state and regional meetings to formulate recommendations for federal action on small business issues. This activity culminated in the 1995 White House Conference on Small Business. The delegates sent to the president and the Congress a list of 60 key recommendations addressing many issue areas, including regulation, paperwork, and taxpayer requirements. These recommendations include cost/benefit analyses, fairer enforcement policies, judicial review of the Regulatory Flexibility Act, and paperwork reduction.

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[9]At the time of this report, the Senate has not adopted corresponding legislation. Similar regulatory reform provisions are included in pending Senate bills.

II. Regulations' Disproportionate Impact on Small Firms

The Theory

The theory of how the costs of regulation, paperwork and tax compliance vary by firm size is relatively straightforward. A significant body of knowledge must be gained by a firm to determine whether a regulation applies to it, whether it is in compliance, or what action must be taken to be in compliance. For example, a firm must first learn that a form is required by rule, determine if the firm is required to submit that form, and then determine how to complete the form correctly. These fixed information-gathering costs are the same for all firms, whether large or small. The large firm advantage is its ability to spread its fixed regulatory costs among more units of output, dollars of sales, or employees, resulting in lower costs per unit. The theory predicts that if the regulatory costs are fixed, the relative burden will decline in proportion to the quantity of goods or services produced (Figure 1).[10]

However, not all regulatory costs are fixed. Costs that grow with an increase in output or firm size, such as labor costs, are variable. With most regulations, these variable costs will be constant per unit of sales or employment.

Every regulation has fixed costs and some regulations have additional variable costs.

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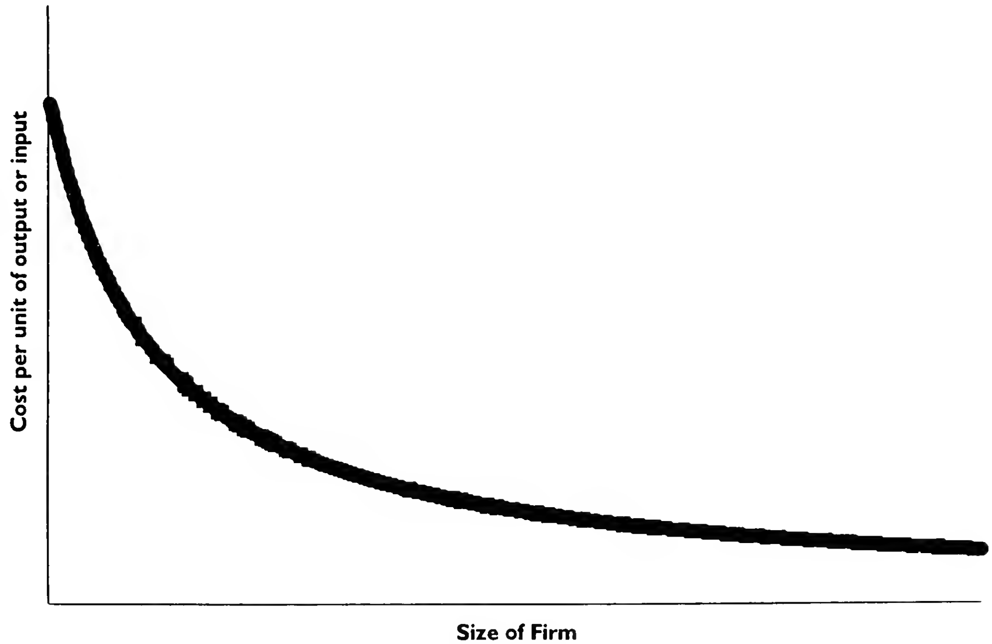
[10]Robert E. Berney, "Non-Neutralities in the Impact of Government Policy and Its Effect on Small Business," *Western Tax Review*, 3, no. 2 (Fall 1982), 22-39; Robert E. Berney and Ed Owens, "Small Business: Government Subsidization, Neutrality or Discrimination," *Journal of Small Business Management*, 22, no. 3 (July 1984), 49-58; Robert E. Berney and James Swanson, "The Regressive Impact of Government Regulations: Some Theoretical and Empirical Evidence," *American Journal of Small Business*, 6, no. 3 (January-March 1982), 16-27.

Figure 1. Cost per Unit of Output or Input, by Size of Firm



Source: U.S. Small Business Administration, Office of Advocacy.

Thus, one would expect that the per-unit regulatory costs will decline as firm size grows. How much these costs decline depends on the relationship between fixed and variable costs.[11] Adding the costs of regulation, paperwork, and tax compliance onto the traditional cost structure raises costs and lowers profits for smaller firms relative to larger firms, suggesting that the startup of new small firms would be more difficult.[12] Thus, the innovative activity brought about by new small firms would be slowed, with the potential dece··ation of economic growth in the industry and the economy.[13]

Compounding the problem, with every new regulation that increases fixed costs, a number of existing small firms may be forced to leave the industry because they cannot cover

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[11]Larger businesses are more likely to gain from the imposition of regulations with heavy fixed costs the more inelastic the supply of labor to the industry and the more inelastic the demand for the industry's product. The more inelastic the supply, the greater the decrease in factor prices resulting from business closures. The more inelastic the demand, the greater the increase in product price resulting from business closures. Also, if more efficient firms are better able to average down fixed regulatory costs, then the largest firms are even more likely to benefit from regulations that impose heavy fixed costs. William Brock and David Evans, *The Economics of Small Businesses* (New York: Holmes & Meyer, 1986), Chapter 5, 86.

[12]Thomas Dean, *Pollution Regulation as a Barrier to the Formation of Small Manufacturing Establishments*, report no. PB95-100277, prepared for the U.S. Small Business Administration, Office of Advocacy (Springfield, Va.: National Technical Information Service, September 1994).

[13]National studies have shown some reduction in economic growth from regulation. For example, Jorgenson and Wilcoxen found that environmental regulations depressed gross national product growth in the 1973-1985 period by 0.2 percent per year (2.5-percent rather than 2.7-percent growth). Dale W. Jorgenson and Peter J. Wilcoxen, "Environmental Regulation and U.S. Economic Growth," *RAND Journal of Economics*, v. 21, no. 2 (Summer 1990). Gray found that some 30 percent of the U.S. decline in manufacturing productivity that began in the 1970s was attributable to EPA and OSHA regulations. Wayne B. Gray, "The Cost of Regulation: OSHA, EPA and the Productivity Slowdown," *American Economic Review*, 77(5) (December 1987), 998-1006. For a more extended discussion, see Thomas D. Hopkins, "The Cost of Federal Regulation," *Journal of Regulation and Social Costs*, 2, no. 1 (March 1992).

the additional costs of the regulations. Competition within an industry will decrease, and the industry structure will become more dominated by large firms.

Since the relative burden on small firms is higher because of the fixed-cost nature of regulation, Congress and a number of regulatory agencies have, on occasion, exempted small firms through "tiering" of the laws and rules.

> Tiering is designing regulations to account for relevant differences among those being regulated. Tiering may be desirable when a uniform rule would otherwise impose disproportionate impacts on regulated businesses. By tiering, an agency can alleviate disproportionate burdens, ensure that the regulatory solution fits the problem, and make more efficient use of its limited enforcement resources. This concept of designing flexible alternatives to uniform rules is the heart of the recently enacted Regulatory Flexibility Act (RFA) (P.L. 96-354). In that act, Congress instructed federal agencies to explore alternatives, such as tiering, to minimize the disproportionate impact of regulations on small businesses, associations and governmental units.
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> In many cases tiering is an effective way of increasing the cost-effectiveness of a regulation. EPA has tiered up to 50 different regulations based either on firm size or the amount of pollutant released. A possible disadvantage is that tiered regulations may provide a disincentive for a firm to grow and, consequently, subject itself to a more stringent standard. Additionally, in certain cases, it may be difficult to set an appropriate tier.[14]

Consequently, empirical studies may or may not show a declining burden by firm size as the theory suggests, depending on the amount of tiering utilized in a particular regulation. Since the passage of the RFA, Congress has frequently required the tiering of regulatory standards for small firms.[15]

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[14]*The State of Small Business: A Report of the President* (Washington, D.C.: U.S. Government Printing Office, 1983), 169-170.

[15]Charles Brown, James Hamilton, and James Medoff, *Employers Large and Small* (Cambridge: Harvard University Press, 1990), 84.

The Evidence

Several reports are available on the relative cost of regulations for large versus small businesses, almost all in response to research requests issued by the Office of Economic Research in the Office of Advocacy and performed under contract with the U.S. Small Business Administration over the last 15 years. Some estimate the costs imposed on small businesses by the rules; others attempt to measure the actual regulation and paperwork costs borne by small businesses.

Small business regulatory burdens may be reduced in a number of ways, both intentional and unintentional. They may be reduced intentionally by tiering. The actual regulatory burdens are also reduced for small firms by the extent to which they are not aware of the regulations or otherwise fail to comply with the rules.

At the direction of the Office of Advocacy, Thomas Hopkins and Diversified Research prepared a study, *A Survey of Regulatory Burdens*. The study found that about 40 percent of the 360 small businesses surveyed indicated that small firms in their industries did not fully comply with most regulations. The small businesses cited ignorance of the rules as the most common cause of this lack of compliance.[16]

In recent years, small firms appear to have been overwhelmed by the growing and constantly changing mass of federal, state, and local requirements. Thus, one might expect regulatory impact studies to differ in result, depending on whether the inquiry is directed at the regulatory burden imposed by the rules, or the regulatory burden actually borne by the

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[16]Thomas D. Hopkins, *A Survey of Regulatory Burdens*, report no. PB95-263190, prepared by Diversified Research, Inc., for the U.S. Small Business Administration, Office of Advocacy (Springfield, Va.: National Technical Information Service, June 1995), 73.

businesses (which may be less because of noncompliance). In fact, this difference has long been noted in the literature.[17]

A 1980 study of actual compliance costs by Battelle[18] found that very small businesses with fewer than 50 employees bear a disproportionate cost burden from regulations, compared with businesses with 50-500 employees. For every one of 21 different compliance costs surveyed in a study of 361 Washington State businesses, the costs were roughly 7 to 10 times higher for the small firms.

Similarly, Jack Faucett Associates found in 1984 that a set of 14 federal regulations promulgated in the late 1970s and early 1980s had a disproportionate impact on small firms.[19] The cost per employee for small firms was 2.83 times that for large firms. The mid-sized firm multiple was 1.35. This report relied solely on the federal government's cost estimates for the proposed rules—not for the final rules that were later promulgated—and therefore, the study only estimated expected costs without measuring the actual costs incurred.

An examination of the actual costs incurred by firms complying with environmental and health and safety regulations between 1974 and 1981 by David Evans shows the contrast

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[17]Brock and Evans, *The Economics of Small Businesses*.

[18]Roland J. Cole and Paul Sommers, *Costs of Compliance in Small and Moderate-Sized Businesses*, report no. PB80-197155, prepared by Battelle Human Affairs Research Centers for the U.S. Small Business Administration, Office of Advocacy (Springfield, Va.: National Technical Information Service, February 1980).

[19]Jack Faucett Associates, *Economies of Scale in Regulatory Compliance: Evidence of the Differential Impacts of Regulation by Firm Size*, report no. PB85-171171, prepared by Jack Faucett Associates for the U.S. Small Business Administration, Office of Advocacy (Springfield, Va.: National Technical Information Service, December 1984).

among some of the empirical studies.[20] In actuality, the Evans study found that large firms spent more per employee than small firms. Specifically, every one percent in establishment employment increase corresponded to a 1.46-percent increase in pollution abatement operating costs for the years 1974-1981.

A 1984 research paper that also addressed pollution costs actually incurred reached conclusions that were contrary to Evans' findings that large firms spend more per employee than small firms. Peter Pashigian found that higher regulatory costs hurt small businesses more than large businesses. This report concluded that industries with high pollution-abatement costs became more capital-intensive, had larger increases in mean plant size (i.e. the number of smaller plants declined over time) and had larger decreases in the number of plants over the years 1972-1977. In addition, small firms' market share in high pollution-abatement-cost industries declined relative to their share of industries with lower costs.[21] However, Brock and Evans questioned the statistical validity of some of Pashigian's results.[22]

In a more recent study, Thomas Dean found that environmental regulations deterred the formation of small establishments, but had no significant effect on large establishment

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[20]David S. Evans, *An Analysis of the Differential Impact of EPA and OSHA Regulations Across Firm and Establishment Size in the Manufacturing Industries*, report no. PB86-158151, prepared by CERA Economic Consultants for the U.S. Small Business Administration, Office of Advocacy (Springfield, Va.: National Technical Information Service, July 1985).

[21]B. Peter Pashigian, "The Effect of Environmental Regulation on Optimal Plant Size and Factor Shares," 26 *Journal of Law and Economics* 1 (1984).

[22]William Brock and David Evans, "The Differential Effect of Regulation Across Plant Size: Comment on Pashigian," *Journal of Law and Economics*, 187 (1985).

formation or establishment size.[23] He postulated that the regulations produced disproportionate impacts on small firms, not only because of the existence of scale economies, but also because of the complexity of the regulations and other unspecified burdens.

Another recent work focused attention on evidence that larger businesses carried relatively larger burdens than did small businesses. Brown, Hamilton & Medoff discussed the proliferation of small business statutory exemptions and relaxed enforcement of regulations on smaller firms.[24] Indeed, a large number of statutes enacted throughout the 1980s and 1990s required tiering of regulations for small businesses, including the Immigration Reform and Control Act of 1986, the Worker Adjustment and Retraining Act of 1988, the Americans with Disabilities Act of 1990, the Clean Air Act Amendments of 1990, and the Family and Medical Leave Act of 1993.

In the 1995 Hopkins and Diversified report, the researchers found that one-third of the firms faced only minor burdens, while two-thirds faced moderate to substantial burdens.[25] They found that total burdens increased with firm size, but that burdens per unit of sales or per employee decreased with firm size.

When firms were asked to describe the types of burdens they face, 94 percent said it was unclear what firms must do to be in compliance, 85 percent cited frequent changes in the regulations or their interpretation, 80 percent said it was difficult to obtain clear and specific answers to questions about compliance, and 80 percent said the requirements to reach full

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[23]Dean, *Pollution Regulation as a Barrier to the Formation os Small Manufacturing Establishments.*

[24]Brown, Hamilton and Medoff, *Employers Large and Small*, 84.

[25]Hopkins, *A Survey of Regulatory Burdens*, 25.

compliance were too costly.[26]

Of the firms that reported moderate to substantial burdens, the smallest firms carried the heaviest burdens, the Hopkins study found. Using this sample of reporting firms, the four smallest firm size classes (firms with 1-4, 5-9, 10-19, and 20-49 employees) reported regulatory spending percentages (costs to revenue) exceeding the average 14 percent of revenue, excluding the relatively modest capital expenditures. Those firms with 20-49 employees spent, on average, 19 cents out of every revenue dollar on regulatory costs.[27]

Reported regulatory costs per employee were highest for the smallest firms with 1-4 employees at $31,748; for the largest firms (500+ employees), total costs per employee were $16,241.[28] However, these normalized cost burdens are based on a sample of 181 businesses and include only firms that reported more than a minor regulatory burden. This Advocacy study, using national data drawn from other academic research, reports lower per-employee costs.

III. Tax-Related Paperwork Burdens

The 1995 Hopkins and Diversified Research study confirms that tax compliance and payroll recordkeeping are the two largest components of regulatory burden today. Small

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[26]Hopkins, *A Survey of Regulatory Burdens*, 38.

[27]Hopkins, *A Survey of Regulatory Burdens*, 25 and Table 7. The costs-to-revenue ratios for each size firm were calculated using the 181 surveyed firms that offered complete responses regarding the proportion of the revenue attributed to operating and maintenance costs, tax paperwork costs, and other regulatory paperwork costs. The relatively small capital costs were omitted from these figures. Because responses were made in ranges (e.g., 2.1 percent to 2.9 percent), Hopkins used the midpoint of the range for his calculations.

[28]Hopkins, *A Survey of Regulatory Burdens*, Table 8.

businesses bear a greater relative burden of tax compliance costs based on their revenue or senior management time. In fact, tax compliance or payroll recordkeeping elicited widespread concerns about burden, although some surveyed firms did mention other regulatory costs that were burdensome. Firms with fewer than 10 employees (excluding firms reporting only minor burdens) reported that their tax and payroll costs represented about 80 percent of their total regulatory burden.[29]

When firms were asked how burdens might be reduced, 95 percent recommended simplifying reporting and recordkeeping, 73 percent suggested additional small business exemptions, and 68 percent asked for more flexible enforcement.[30]

In the only study available in the United States on the impact of tax-related paperwork on all firms by firm size, the Tax Foundation reports that the smallest firms spend 0.5 percent of their sales on tax compliance activity; the largest firms spend less than 0.1 percent of their sales on tax paperwork (Table 1).[31] The more recent 1995 Hopkins and Diversified

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[29]Hopkins, *A Survey of Regulatory Burdens*, 34, 51-58. Also mentioned were costs for worker safety, wage-and-hour reporting, environment, equal opportunity, and ADA, among others.

[30]Hopkins, *A Survey of Regulatory Burdens*, 72.

[31]Arthur P. Hall, *The High Cost of Tax Compliance for U.S. Business*, Tax Foundation special report no. 25 (Washington, D.C.: The Tax Foundation, November 1993). This study, along with IRS taxpayer paperwork burden estimates, is based on a 1988 Arthur D. Little study that surveyed some 4,000 corporations and partnerships and 1,500 tax preparers. (No sole proprietorships were included.) According to the IRS, these burdens have remained relatively constant since 1984 (four years before the Arthur D. Little study). It is only the hourly cost of completing the tax forms that has increased. Studies for the United Kingdom, Australia, and New Zealand show a similar taxpayer compliance regressive burden, that is, a burden that decreases with increases in firm size. It is only in very large corporations that the complexity of the return causes the cost of compliance to increase with firm size.

The General Accounting Office (GAO) has reviewed seven studies issued since 1980

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study shows that the smallest firms (those with fewer than 50 employees) spend closer to 5 percent of revenue on tax compliance costs.[32]

Recent administration actions have been undertaken that could significantly reduce the taxpayer compliance burdens, including a proposed increase from $10,000 to $25,000 in 1993 (subsequently reduced by Congress to $17,500) in the amount of capital investment that businesses can expense; simplified calculations for computing the individual alternative minimum tax, simplified and unified determination of depreciation deductions (allowing taxpayers to group certain assets in one or more "general asset" accounts), an increased threshold for recordkeeping on meals and entertainment expenses from $25 to $75, and rules that would allow an unincorporated entity to elect to be treated as a partnership by simply checking a box on its tax return (replacing complicated business form criteria).

The administration has moved forward on the Simplified Tax and Wage Reporting System (STAWRS) that will ultimately enable an employer to file a single return providing

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31(...continued)
that provide some estimate of federal or state tax compliance costs. GAO concluded that it could not identify "a readily available, reliable estimate of such costs." See Lydia Willis, *Tax Compliance Burden Faced by Business Taxpayers*, General Government Division, General Accounting Office, Testimony, U.S. House of Representatives, Committee on Ways and Means, Subcommittee on Oversight, December 19, 1994, 5-6. The GAO cites: (1) the complexity of separating tax compliance costs from normal business expenses, (2) the difficulty of businesses estimating such costs, (3) low response rates, and (4) the limited coverage of taxpayer groups in the surveys. The GAO concludes that while it could not identify reliable tax burden estimates, there was a "consensus... [that the] tax compliance burden is significant and that it can be reduced."

[32]Hopkins, *A Survey of Regulatory Burdens*, Table D-10. These higher costs may be explained by the difficulty of estimating tax compliance costs, and other reasons cited in the 1994 GAO testimony. See previous footnote.

Table 1 Estimated Cost of Corporate Income Tax Compliance by Amount of Company's Annual Sales

Annual Sales (Thousands of Dollars)	Compliance Cost-to-Sales Ratio (Percent)	Estimated Compliance Cost (Dollars)
1,000	0.50	5,025
25,000	0.50	126,000
50,000	0.50	251,000
100,000	0.47	470,000
250,000	0.13	325,000
500,000	0.13	650,000
750,000	0.12	900,000
1,250,000	0.07	875,000
2,000,000	0.08	1,600,000
3,000,000	0.07	2,100,000
5,000,000	0.07	3,500,000
7,500,000	0.05	3,750,000
10,000,000	0.05	5,000,000

Source: Arthur P. Hall, The High Cost of Tax Compliance for U.S. Business, Special Report No. 25, Tax Foundation, November 1993.

payroll and tax information electronically (or, for a small business, on one sheet of paper that can be copied). This system would eliminate the need to file multiple reports with state and federal agencies that require the same data. Finally, the administration has proposed reforms to ease rules for participation in pension plans, and reduce the frequency and quantity of information reports. These measures should prove very beneficial to small businesses.

IV. Trends in the Burdens of Regulation on the Private Sector

In his new study for the Office of Advocacy,[33] Thomas Hopkins updates his earlier estimate of the total cost burden of regulation on the economy, and then projects how these regulatory burdens are distributed to major sectors of the economy and by firm size. His initial work, "The Cost of Federal Regulations," was published in 1992. A second, unpublished paper written in 1992, "Cost of Regulation: Filling the Gaps," updates the first paper and provides more details on where the regulatory burdens come from and where they fall (Table 2).[34]

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[33]See *Profiles of Regulatory Costs*. Hopkins, a professor at Rochester Institute of Technology, is the leading scholar in the field. His reports are the starting point for almost all researchers who study this topic. The Heritage Foundation also made estimates, which are significantly higher ($810 billion to $1.7 trillion for 1992, with benefits reportedly netted out). Support for these estimates is not as well documented as in Hopkins, among others. For a current example, see U.S. General Accounting Office, *Regulatory Reform: Information on Costs, Cost-Effectiveness and Mandated Deadlines for Regulations*, AO/PEMD-95-18BR (Washington, D.C.: U.S. General Accounting Office, March 1995). Hopkins was at the Office of Management and Budget when he did his first estimates of total regulatory costs.

[34]Hopkins, "The Cost of Federal Regulation," 5-31. See also Thomas D. Hopkins, "Cost of Regulation: Filling the Gaps," mimeographed, August 1992. The second paper, with a more complete analysis and newer data, raised his preliminary total cost of regulation estimate by some $100 billion to $564 billion in 1992. See also Thomas D. Hopkins,

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Paperwork Costs

The OMB's report on paperwork dated October 1993 reported 6.64 billion hours of federal paperwork for fiscal year 1992, including 5.60 billion hours from IRS taxpayer compliance.[35] This represents a 0.7-percent decrease from the previous year's level. OMB projected a 2-percent decrease for fiscal year 1993, followed by a 0.5-percent increase for fiscal year 1994.[36] Hopkins uses the OMB paperwork hourly estimates, and assumes a $26 per hour labor rate to calculate the cost for the paperwork portion of "process regulations."[37]

Total Regulatory Costs

Hopkins adds the cost of process regulations to environmental and other social and

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34(...continued)
"Statement Before the Subcommittee on Oversight and Investigations," U.S. House of Representatives, Subcommittee on Oversight and Investigations of the Committee on Economic and Educational Opportunities and the Subcommittee on Regulation and Paperwork of the Committee on Small Business, mimeographed, February 2, 1995, and "Federal Regulatory Burdens and Overview," RIT Public Policy Working Paper, Rochester Institute of Technology, 1993.

[35]Office of Management and Budget, *Managing Federal Information Resources* (Washington, D.C.: Office of Management and Budget, October 1993), 14.

[36]Office of Management and Budget, *Information Resources Management of the Federal Government* (Washington, D.C.: Office of Management and Budget, December 1993), II-7, II-8.

[37]Hopkins, *Profiles of Regulatory Costs*, 21. See the definition of process costs in the next footnote.

Table 2 Distribution of Compliance Costs in 1991 (Percent)

	Percent
Environmental	
Air and Radiation	33.3
Water	48.0
Land	14.6
All Others	4.1
Other Social Regulation	
Worker Health and Safety	33.6
Auto Safety	29.5
Nuclear Safety	24.7
Other Consumer Protection	8.7
Job Security	3.5
Economic Regulation	
Transportation	30.7
International Trade	27.3
Communication	22.3
Agricultural/Natural Resources	11.6
Financial	6.9
Other Economic	1.2
Process Regulation	
Paperwork	74.4
State - Local Mandates	3.7
Health	21.9

Source: Thomas D. Hopkins, Cost of Regulation: Filling the Gaps, August 1992.

economic regulatory costs[38] to derive an estimate of total regulatory costs of $668 billion (in 1995 dollars) in 1995, increasing to $721 billion in 2000.[39] (See Table 2 for the components of each of these terms and Table 3 and Figure 2 for the costs.) Total costs fell from 1977 to 1988 and then increased from 1988 to 2000.

Although Hopkins projects costs well into the future (to the year 2000), the Office of Advocacy believes these figures are highly speculative. Hopkins' future projections are likely an overestimate because he does not estimate the cost reductions that will accrue from the administrative and congressional initiatives to reinvent government and reduce government regulation. Furthermore, it is extremely difficult to estimate the future costs, for example, of

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[38]Social regulations are mandates aimed at achieving social goals, such as protecting people and the environment from hazards. Environmental regulations include control of air and water pollution, the handling and labeling of hazardous materials, noise regulation and nuclear power safety. Most of the costs of social regulation stem from environmental regulation. The category of "other social regulation" includes occupational health and safety regulation, labor-management relations, consumer product safety, pensions, ADA and family leave requirements.

Economic regulations are divided into two cost components: efficiency costs, which involve the use of real resources, and transfer costs, which direct resources from one sector of the economy to another. Economic efficiency regulations include agricultural, communications, transportation, energy, financial, construction, and international trade regulations. About half of the economic transfer costs stem from transfers to stimulate exports. Agricultural price supports are also included in transfer costs.

Process costs are costs arising from government-imposed processes. These include tax paperwork, health care regulatory paperwork, and the costs of meeting federal mandates placed on state and local governments.

[39]In its recent review of regulatory costs, utilizing the very similar 1993 costs developed by Professor Hopkins, the GAO states: "What is clear is that the measures and assumptions used have large impacts on the estimates, imposing a great deal of uncertainty on them." U.S. General Accounting Office, *Regulatory Reform: Information on Costs, Cost-Effectiveness and Mandated Deadlines for Regulations*, AO/PEMD-95-18BR (Washington, D.C.: U.S. General Accounting Office, March 1995), 19. This comment also applies to the Office of Advocacy's use of Hopkins' updated 1995 figures.

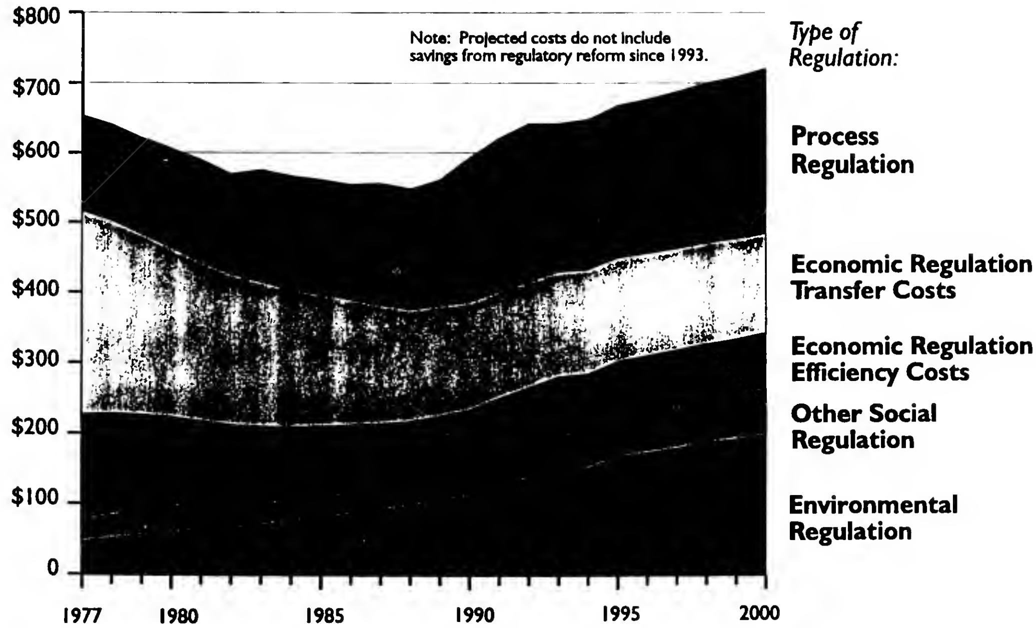
Table 3. Annualized Regulatory Costs in Billions of 1995 Dollars

Year	Environmental Regulation	Other Social Regulation	Economic Regulation Efficiency Costs	Economic Regulation Transfer Costs	Process Regulation	Total Regulatory Costs
1977	47	32	149	288	138	654
1978	52	35	142	273	139	640
1979	56	37	134	256	139	623
1980	60	39	125	239	143	605
1981	63	37	118	225	147	590
1982	65	35	113	213	144	570
1983	71	32	108	204	161	576
1984	76	31	103	194	163	567
1985	81	31	99	186	165	561
1986	87	31	95	177	165	555
1987	93	32	90	168	174	557
1988	98	34	86	158	173	548
1989	105	36	85	156	180	561
1990	112	39	83	153	206	593
1991	129	40	82	151	219	621
1992	137	47	82	150	226	642
1993	149	51	81	149	212	642
1994	152	53	80	148	215	649
1995	168	55	80	147	218	668
1996	174	58	79	145	221	677
1997	180	60	79	144	225	688
1998	188	62	78	143	229	700
1999	193	65	77	142	232	709
2000	199	68	77	141	236	721

Projected costs do not include savings from regulatory reform since 1993.

Source: Thomas D. Hopkins, Profiles of Regulatory Costs, SBA Contract No. SBAHQ-95-M-0298 (Draft Final Report, 1995).

Figure 2. Regulatory Costs, 1977 – 2000 (Billions of 1995 Dollars)



Source: Thomas D. Hopkins, "Profiles of Regulatory Costs" (draft final report, 1995).

environmental and tax regulations that have yet to be written. Therefore, these future projections are only suggestive of possible trends.

The business community has total regulatory costs of some $400 billion, up from the $330 billion range in 1988. When the business share of regulatory costs is distributed across sectors, it appears that manufacturing firms carry about one-third of all business regulatory costs in 1995. The rest of the costs are borne in roughly equal shares by trade, services and all other industries. In constant dollars, the manufacturing regulatory burden has climbed sharply since 1982, while the other sectors have experienced little change. (See Figure 6 for the distribution of costs by business sector.)

The economic regulatory burden declined in the late 1970s with the deregulation of transportation, natural gas and oil, and communications. The burden of economic regulations has remained basically constant since 1988 and was expected to remain constant into the 21st century.[40]

Process regulation in 1992 accounted for some 40 percent of total business regulatory costs, while environmental regulation was the source of about a quarter of total business regulatory costs. The burdens that are increasing are environmental regulation and process (primarily paperwork) regulation (Figure 3).

When total costs are expressed relative to gross domestic product (GDP), a decline also occurred from 1977 to 1988 (Figure 4). While regulatory burdens have been increasing

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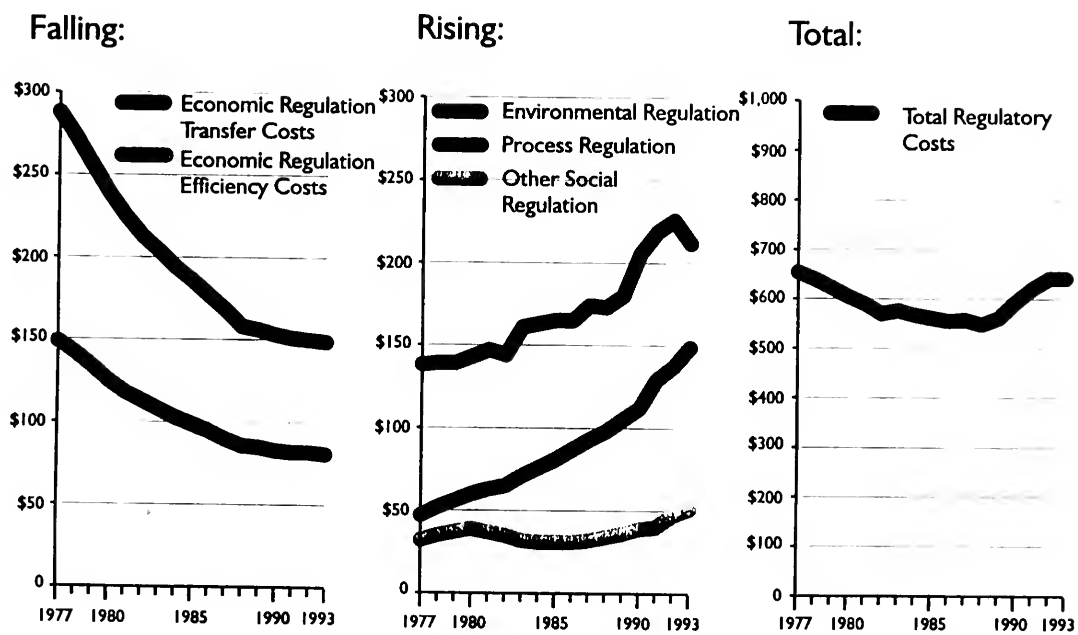
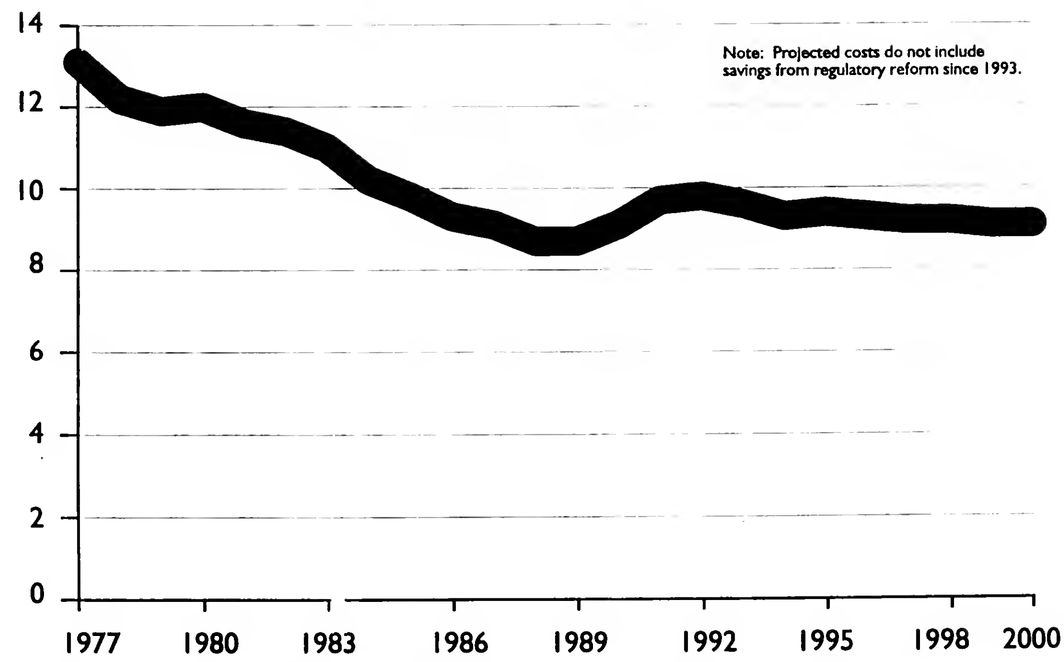
[40]Some researchers using Hopkins' data omit the economic regulation transfer costs, maintaining that they are not societal costs but simply transfers of funds from the consumer to the protected producer. But the same is true in the area of taxation, where a large proportion of tax revenues are used to fund entitlements. Thus, transfer costs are retained in this Advocacy analysis.

Figure 3. Regulatory Costs by Category, 1977 – 1993 (Billions of 1995 Dollars)



Source: Thomas D. Hopkins, "Profiles of Regulatory Costs" (draft final report, 1995).

Figure 4. Regulatory Costs as Percent of GDP, 1977 – 2000



Note: Regulatory cost figures computed using EPA estimates for the environmental regulatory cost component.

Source: Thomas D. Hopkins, "Profiles of Regulatory Costs" (draft final report, 1995).

in absolute terms for the past decade, since 1992, the increases have only matched the increases in GDP. In other words, regulatory burdens have remained at approximately 9 percent of GDP. Hopkins expects this relationship to continue through the year 2000.

V. Total Benefits of Regulation

Ideally, the true measure of the burden of regulation is determined by the difference between the total costs and the total benefits. Unfortunately, although the benefits of regulations are important, no reliable estimates of total benefits exist. According to a carefully documented report by the Harvard Center for Risk Analysis, federal regulations have had significant beneficial effects:[41]

> For example, over the past 30 years the United States has made substantial progress in cleaning up air, water and land, in part due to the strong regulatory presence of the federal government.[42] The automobile manufacturing industry is now producing cars that emit 75-95 percent fewer pollutants from tailpipes than they did in 1968—a rate of progress that would not have been achieved without strong federal regulation.[43] Prevention of lead pollution has been a notable success story, as the national rate of lead emissions from all man-made sources has declined 96 percent since 1970,[44] and the concentrations of lead in the blood of children has fallen substantially, particularly

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[41]Center for Risk Analysis, Reform of Risk Regulation: *Achieving More Protection at Less Cost* (Boston, Massachusetts: Harvard University, School of Public Health, March 1995), 8.

[42]Council on Environmental Quality, *Environmental Quality: 21st Annual Report* (Washington, D.C.: Council on Environmental Quality, 1990); Paul Portney, ed., *Public Policies for Environmental Protection* (Washington, D.C.: Resources for the Future, 1990).

[43]*Motor Vehicle Facts and Figures* (Detroit, Mich.: U.S. Motor Vehicle Manufacturers Association, annual).

[44]Council on Environmental Quality, *Environmental Quality: 21st Annual Report*, Table 39.

since the lead content of gasoline was reduced and then eliminated.[45] Product manufacturers have also responded to regulatory and liability pressure by paying more attention to safety in both design and manufacturing.[46] Many new cost-effective safety features have been added to products (e.g., airbags in automobiles) as a result of the continued prodding and regulatory presence of the federal government.[47] . . . In short, many risk-reduction policies have been shown to have benefits greater than costs, even though benefits are sometimes difficult to estimate.[48]

Hopkins' 1993 paper also includes some information about benefits:[49]

The net benefits of environmental regulation may be positive or negative. By 1990, the benefits of air pollution regulations probably were exceeding the compliance costs, perhaps by as much as $10 billion. For water pollution regulations, on the other hand, the results were just the opposite. The best information available suggests that costs exceeded benefits by roughly $20 billion per year in the water pollution area. For other environmental areas, we lack comparable data. The general trend appears to be the adoption of regulations whose benefits do not exceed their costs. The 1990 Clean

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[45]Joel Schwartz, "The Link Between Lead in People and Lead in Gas," *EPA Journal*, vol. 11 (1985), 12; M. J. Kosnett, et al., "Factors Influencing Bone Lead Concentration in a Suburban Community Assessed by Noninvasive K X-ray Fluorescence," *Journal of the American Medical Association*, vol. 27 (1994), 197.

[46]P. Huber and R. Litan, eds., *The Liability Maze: The Impact of Liability Law on Safety and Innovation* (Washington, D.C.: The Brookings Institution, 1991), G.F. Tietz, "Strict Products Liability, Design Defects, and Corporate Decision Making: General Deterrence Through Stricter Process," *Villanova Law Review*, vol. 38 (1993), 1391.

[47]John D. Graham, *Auto Safety: Assessing America's Performance* (Westport, Conn.: Praeger, 1989).

[48]U.S. Environmental Protection Agency, *The Costs and Benefits of Reducing Lead in Gasoline*, Final Regulatory Impact Analysis (Washington, D.C.: U.S. Environmental Protection Agency, 1985); R. Crandall, H. Gruenspecht, T. Keeler, L. Lave, *Regulating the Automobile* (Washington, D.C.: The Brookings Institution, 1986); R. Luken, *Efficiency in Environmental Regulation* (Boston, Mass.: Kluwer Academic Publishers, 1990); W. Kip Viscusi, *Fatal Tradeoffs; Public and Private Responsibilities for Risk* (New York, N.Y.: Oxford University Press, 1992); A.M. Freeman, *The Measurement of Environmental and Resource Values* (Washington, D.C.: Resources for the Future, 1993); D. Kamerud, "Benefits and Costs of the 55 Mph Speed Limit," *Journal of Policy Analysis and Management*, vol. 7 (1988), 341-352; J.D. Graham and M. Henrion, "A Probabilistic Analysis of the Passive-Restraint Question," *Risk Analysis*, vol. 4 (1984), 25-40.

[49]Hopkins, "Federal Regulatory Burdens and Overview," 4.

> Air Act Amendments very likely will impose additional compliance costs of $30 billion annually while generating far smaller additional benefits. This trend is driven in part by the fact that many of the low cost options for lessening risks already have been adopted.

The burdens of regulation, like taxes, fall specifically on the persons or businesses that pay, whereas the benefits tend to be more generally distributed. Therefore, the complaints of the regulated will be more focused than the appreciation of those benefiting from the regulation. Thus, while it is common to focus on the more obvious cost of regulation, the more elusively determined net benefit provides the public policy foundation for a given rule.

VI. Allocation of the Burden of Regulations by Industry and Firm Size

Hopkins' Estimates

Regulatory burden estimates for small firms have been made for a specific regulation or sets of regulations in previous studies by asking business owners to estimate their costs. To date, there has been no attempt to allocate total regulatory costs across business sectors and firm sizes.

Based on his previous work, Thomas Hopkins of the Rochester Institute of Technology was selected to fill this critical data gap. In his earlier study for the Office of Advocacy, Hopkins surveyed 360 firms, most of them small (with fewer than 500 employees), in 15 different industries.[50] Based on the survey, he developed estimates by firm

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[50]Hopkins, *A Survey of Regulatory Burdens*.

size of the cost of regulation, along with costs per employee and per dollar of sales.

The Office of Advocacy requested that Hopkins attempt this first approximation of total burdens by firm size, using the data from his previous studies and elsewhere. Several steps were required.

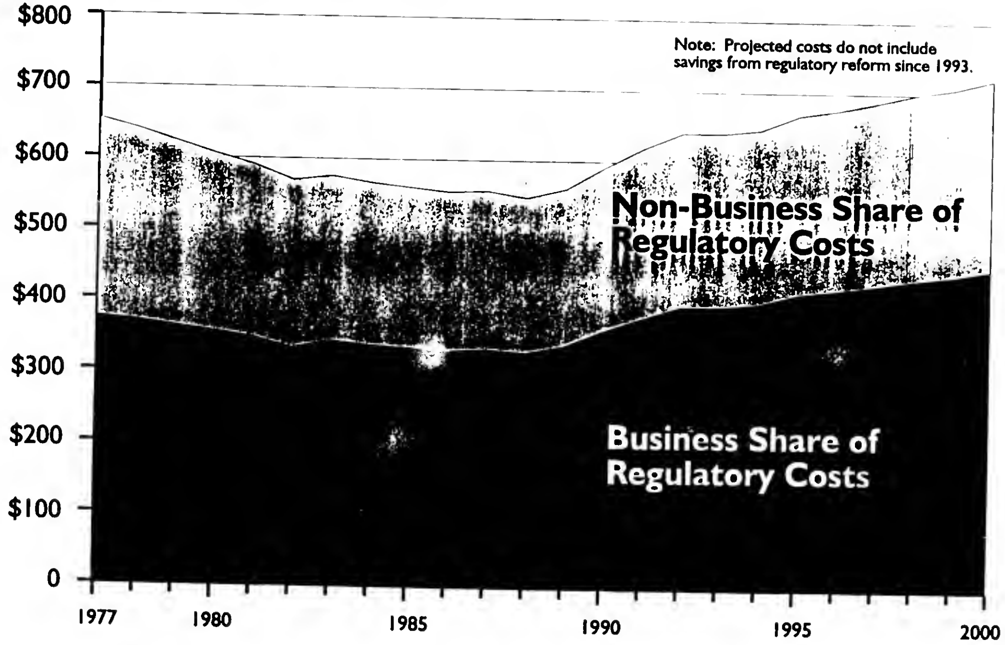
Initially, Hopkins separated the regulatory burdens that fall on consumers or state and local governments from the burdens that fall on business. The business costs were divided into industrial sectors, and further subdivided by firm size. The following allocation rules that were developed in earlier research studies or from anecdotal evidence were used to separate business from nonbusiness regulatory costs:[51]

	Percent of Regulatory Costs Borne By	
	Business	Government & Consumers
Environmental regulation	65	35
Other social regulation	100	
Economic regulation (transfer and efficiency costs)	50	50
Process regulation (primarily paperwork)		
Mandates		100
Health care	50	50
Tax paperwork	67	33
Other paperwork		100

The allocation of—and trends in—these costs are shown in Figure 5. The business costs were then allocated to the various industrial sectors using research and anecdotal evidence:

[51] Hopkins, *Profiles of Regulatory Costs*, 13-14.

Figure 5. Business Share of Regulatory Costs, 1977 – 2000 (Billions of 1995 Dollars)



Source: Thomas D. Hopkins, "Profiles of Regulatory Costs" (draft final report, 1995).

	Percent of Regulatory Costs Borne By			
	Manufacturing	Trade	Services	Other
Environmental regulation	70	10	10	10
Other social regulations	40	20	20	20

For all other regulation (economic and process), costs are allocated across the four sectors in proportion to the employment share.[52]

These allocations and the resulting trends through time are shown in Figure 6.

The scheme for allocating costs by firm size was derived using data in the Hopkins study, *A Survey of Regulatory Burdens*. Among the enterprises facing at least moderate regulatory burdens per employee, firms employing fewer than 20 employees reported costs that exceeded the average cost per employee for all firms by 30 percent.[53] Hopkins divided the total regulatory cost per sector by the number of employees to derive the average cost per employee. The average cost per employee is multiplied by 130 percent to represent the cost for the smallest firms, and the remaining cost is allocated to the 20-499 employee size firms and large firms (500+ employees).[54] His results are shown in Table 4.

For the entire United States, the average cost of regulation per employee in 1992 (1995 dollars) is:

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[52]Allocations to each individual firm are determined by dividing the total sector costs into the number of firms in each industrial sector as reported in Census data for 1992, the latest year for which data are available.

[53]Hopkins, *A Survey of Regulatory Burdens*, Table 8, 30.

[54]Large firm costs were allocated at 70 percent of the average cost per employee, and the 20-499 employee size firms were allocated all of the remaining industry costs.

<20 employees	$ 5,532
20-499 employees	$ 5,298
>500 employees	$ 2,979

The smallest firms' regulatory costs per employee are 1.86 times those of the largest firms.

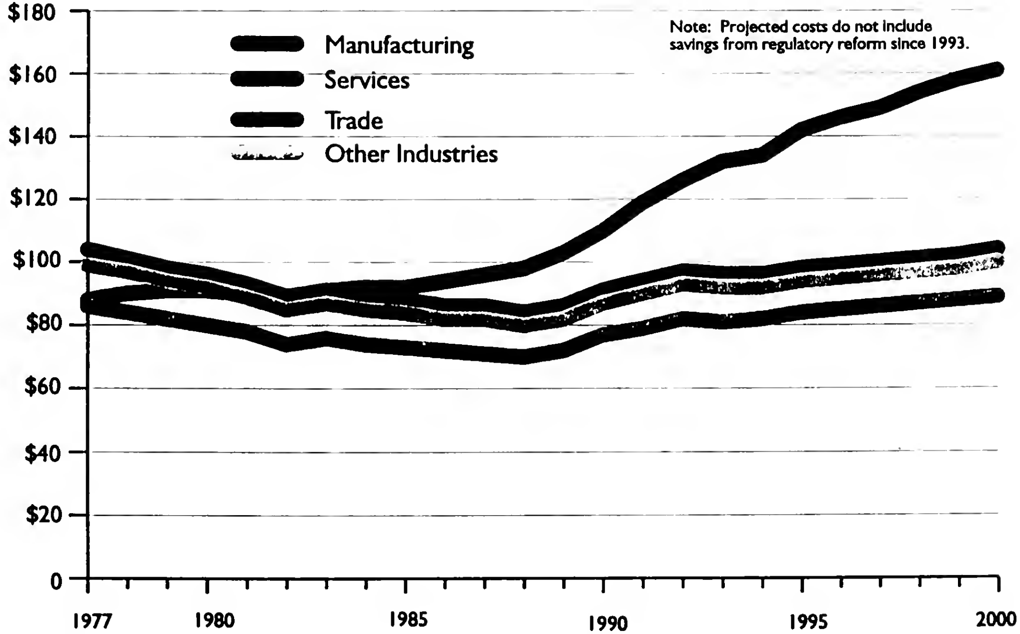
For manufacturing, where the regulatory costs are the highest, the cost per employee in 1992 is about double the average cost per employee across the entire economy:

<20 employees	$ 9,016
20-499 employees	$10,605
>500 employees	$ 4,855

In the service industry, where the costs are the lowest, the costs per employee in 1992 are:

<20 employees	$ 3,985
20-499 employees	$ 3,558
>500 employees	$ 2,146

Figure 6. Business Regulatory Costs by Industry Sector, 1977 – 2000 (Billions of 1995 Dollars)



Source: Thomas D. Hopkins, "Profiles of Regulatory Costs" (draft final report, 1995).

Table 4. Business Regulatory Burdens by Sector, 1992 - The Hopkins Case (1995 Dollars)

Manufacturing

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	62	188,909	3,413	4,437	5,218	2,389	1.8
Other Social	19	57,891	1,046	1,360	1,599	732	0.6
Economic (Efficiency Costs)	7	21,328	385	501	589	270	0.2
Economic (Transfer Costs)	13	39,610	716	930	1,094	501	0.4
Process	25	76,173	1,376	1,789	2,104	963	0.7
Total Regulatory Costs	126	383,911	6,936	9,016	10,605	4,855	3.7

Trade

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	9	6,125	349	454	411	244	0.2
Other Social	9	6,125	349	454	411	244	0.2
Economic (Efficiency Costs)	10	6,806	388	504	456	272	0.2
Economic (Transfer Costs)	18	12,250	698	908	821	489	0.3
Process	35	23,819	1,358	1,765	1,596	950	0.6
Total Regulatory Costs	82	55,805	3,181	4,135	3,740	2,227	1.4

Services

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	9	4,584	293	382	341	205	0.5
Other Social	9	4,584	293	382	341	205	0.5
Economic (Efficiency Costs)	12	6,111	391	509	454	274	0.6
Economic (Transfer Costs)	22	11,204	717	933	833	502	1.1
Process	42	21,390	1,370	1,780	1,590	959	2.1
Total Regulatory Costs	94	47,872	3,065	3,985	3,558	2,146	4.8

Table 4. Business Regulatory Burdens by Sector, 1992 - The Hopkins Case (1995 Dollars)--Continued

Other

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	9	6,563	494	642	608	346	0.2
Other Social	9	6,563	494	642	608	346	0.2
Economic (Efficiency Costs)	12	8,751	659	856	810	461	0.3
Economic (Transfer Costs)	22	16,043	1,208	1,570	1,486	845	0.6
Process	42	30,627	2,306	2,997	2,836	1,614	1.1
Total Regulatory Costs	93	67,817	5,105	6,637	6,280	3,574	2.4

U.S. Totals

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	89	17,467	959	1,246	1,194	671	0.6
Other Social	47	9,224	506	658	630	354	0.3
Economic (Efficiency Costs)	41	8,047	442	574	550	309	0.3
Economic (Transfer Costs)	75	14,719	808	1,050	1,006	566	0.5
Process	144	28,261	1,551	2,017	1,931	1,086	1.0
Total Regulatory Costs	395	77,522	4,255	5,532	5,298	2,979	2.7

Numbers may not add due to rounding.

Source: Thomas D. Hopkins, Profiles of Regulatory Costs, SBA Contract No. SBAHQ-95-M-0298 (Draft Final Report, 1995).

The Office of Advocacy's Estimates

The Office of Advocacy believes that Hopkins overestimates the allocation of the burdens on small firms. In his earlier study, about one-third of the small firms reported only minor regulatory burdens.[55] Hopkins' use of the 30-percent greater-than-average figure per employee for small firms excludes consideration of the firms with only minor costs. In order to present a more balanced estimate of the allocation of burdens, the Office of Advocacy projects that when firms with minor burdens are included, a 20-percent greater-than-average figure is more appropriate for small firms. Twenty percent below the average should be used for large firms (Table 5).

Total regulatory costs per employee (in dollars) for all sectors are shown below:

	<20	20-499	>500	Sm/Lg
Hopkins' estimate	5,532	5,298	2,979	1.86
Advocacy's estimate	5,106	4,950	3,404	1.50

If total regulatory costs are divided by total sales (or receipts), the differentials become even larger:

	<20	20-499	>500	Sm/Lg
Hopkins' estimate	.044	.040	.018	2.44
Advocacy's estimate	.040	.038	.021	1.90

[55]Hopkins, *A Survey of Regulatory Burdens*, 23.

Table 5. Business Regulatory Burdens by Sector, 1992 - The Advocacy Case (1995 Dollars)

Manufacturing

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	62	188,909	3,413	4,095	4,617	2,730	1.8
Other Social	19	57,891	1,046	1,255	1,415	837	0.6
Economic (Efficiency Costs)	7	21,328	385	462	521	308	0.2
Economic (Transfer Costs)	13	39,610	716	859	968	572	0.4
Process	25	76,173	1,376	1,651	1,862	1,101	0.7
Total Regulatory Costs	126	383,911	6,936	8,323	9,382	5,549	3.7

Trade

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	9	6,125	349	419	390	279	0.2
Other Social	9	6,125	349	419	390	279	0.2
Economic (Efficiency Costs)	10	6,806	388	466	433	310	0.2
Economic (Transfer Costs)	18	12,250	698	838	780	559	0.3
Process	35	23,819	1,358	1,629	1,517	1,086	0.6
Total Regulatory Costs	82	55,805	3,181	3,817	3,554	2,545	1.4

Services

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	9	4,584	293	352	325	235	0.5
Other Social	9	4,584	293	352	325	235	0.5
Economic (Efficiency Costs)	12	6,111	391	470	433	313	0.6
Economic (Transfer Costs)	22	11,204	717	861	794	574	1.1
Process	42	21,390	1,370	1,644	1,516	1,096	2.1
Total Regulatory Costs	94	47,872	3,065	3,678	3,394	2,452	4.8

Table 5. Business Regulatory Burdens by Sector, 1992 - The Advocacy Case (1995 Dollars)--Continued

Other

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	9	6,563	494	593	570	395	0.2
Other Social	9	6,563	494	593	570	395	0.2
Economic (Efficiency Costs)	12	8,751	659	790	760	527	0.3
Economic (Transfer Costs)	22	16,043	1,208	1,449	1,393	966	0.6
Process	42	30,627	2,306	2,767	2,659	1,844	1.1
Total Regulatory Costs	93	67,817	5,105	6,126	5,889	4,084	2.4

U.S. Totals

Type of Regulation	Total Cost (billions)	Cost per Firm	Average Cost per Employee	Cost per Employee by Firm Size <20	20 to 499	500+	Cost as a Percent of Receipts
Environment	89	17,467	959	1,151	1,115	767	0.6
Other Social	47	9,224	506	608	589	405	0.3
Economic (Efficiency Costs)	41	8,047	442	530	514	353	0.3
Economic (Transfer Costs)	75	14,719	808	970	940	646	0.5
Process	144	28,261	1,551	1,862	1,805	1,241	1.0
Total Regulatory Costs	395	77,522	4,255	5,106	4,950	3,404	2.7

Numbers may not add due to rounding.

Source: Thomas D. Hopkins, Profiles of Regulatory Costs, SBA Contract No. SBAHQ-95-M-0298 (Draft Final Report, 1995).

The story is basically the same: Even after the most crucial assumption in the analysis is adjusted in favor of large firms, small firms pay significantly more than large firms per employee or dollar of sales.

VII. The Future of Regulation

The average cost of regulation, paperwork, and taxpayer requirements per employee in 1992, as estimated by Hopkins, is in the $5,400 range for small firms and the $3,000 range for large firms. Although these figures are only approximations, the difference between large and small firm—some 80 percent—is very significant.

The more conservative Advocacy estimates for the small firm are in the $5,000 range and, for the large firm, some $3,400 per employee. Under either scenario, this huge differential handicaps a new innovative entrepreneur in competition with larger firms.

The total regulatory costs for small and large firms are estimated in Table 6. Using the Hopkins scenario, firms with fewer than 500 employees have a total regulatory, paperwork and tax compliance burden of $265 billion, while firms with more than 500 employees have a total burden of $130 billion. Firms with fewer than 500 employees bear 67 percent of the total burden of regulation, paperwork and tax compliance.

Using the more conservative Advocacy numbers, the total small firm burden is $247 billion and the large firm burden is $148 billion; thus small firms bear 63 percent of the total regulatory, paperwork and tax compliance burden. Because small firms generate some 50 percent of the employment and sales, this indicates that the burden is too heavy on the

Table 6: Business Regulatory Costs of Employees, 1992 (in billions of 1995 Dollars)

Type of Regulation	Total Cost per Employee by Firm Size < 500	500+	Total
A. Hopkins' Case*:			
U.S. Total	265	130	395
Environmental	60	29	89
Other Social	32	15	47
Economic–Efficiency	28	13	41
Economic–Transfer	51	25	75
Process	97	47	144
B. Advocacy's Case**:			
U.S. Total	247	148	395
Environmental	56	33	89
Other Social	29	18	47
Economic–Efficiency	26	15	41
Economic–Transfer	47	28	75
Process	90	54	144

Numbers may not add due to rounding.

* Assumes small firms experience total employee costs that are 30% higher than the average, and that the largest firms experience total employee costs that are just 70% of the average.

** Assumes small firms experience total employee costs that are 20% higher than the average, and that the largest firms experience total employee costs that are just 80% of the average.

Source: Thomas D. Hopkins, Profiles of Regulatory Costs, SBA Contract No. SBAHQ–95–M–0298 (Draft Final Report, 1995)

smaller firms.

The data regarding the disproportionate impact on smaller firms establish that regulatory costs are not being allocated fairly. If the nation's goals are to generate employment and innovation, improve global competitiveness, and encourage economic growth, government actions should not impose disproportionate cost burdens on the small business sector to solve other problems. The lesson here is that policymakers must implement additional efforts to identify ways to minimize these burdens, while still achieving the regulatory goals.[56]

If there is a White House Conference on Small Business in the year 2005, many expect that small business owners will still list regulation, paperwork, and taxes as a primary concern. It is unlikely that the regulatory burden relative to the size of the economy will have changed significantly. However, if the spirit of cooperation between the regulatory agencies and the small business community continues well beyond the 1995 White House Conference on Small Business and if Congress continues to revise the legislative mandates, there could be a significant downward trend in the regulatory burden faced by small firms.

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[56]The Regulatory Flexibility Act mandates that regulators analyze the impact on small firms, and tailor the rules to address both small business needs and statutory mandates.

Chairman BOND. Thank you very much, Mr. Glover. I am going to reserve my time and turn to my colleague, Chairwoman Meyers.

Chairwoman MEYERS. Thank you, Senator Bond. I would like to ask one question and then will reserve the balance of my time, also.

Obviously, the greatest impact of regulations is in IRS. One of the reasons is because everyone pays taxes while not everyone is impacted by OSHA or EPA or some of the other agencies. However, I think you did mention that one-third of the businesses said that they had a very low impact. Are those the businesses that are single person, maybe sometimes in a home office? Or is that one-third in a specific sector?

Mr. GLOVER. No, it was very interesting. The one-third cut across the various size categories. We had a little less than one-third in the over 500 category say they did not consider regulations to be a real problem, which came as a real surprise to me, because a 500-man firm is likely to have some regulatory burdens I would think, but they answered the questions no, they did not see that much of a burden. But it was across all industry sectors and across all size categories.

Chairwoman MEYERS. Thank you, Mr. Glover.

Finally, if IRS imposes the greatest burden on businesses generally and small business particularly, we all know that Regulatory Flexibility would help a great deal for small business. But in addition to that, I would think that the IRS impact would indicate that the expensing provision and the home office deduction that we passed in the House are of tremendous importance, since they both would have a tax impact. Would you comment on that?

Mr. GLOVER. I agree with you wholeheartedly. We have increased expensing over the last few years. Home office deduction numbers are important. One of the things the IRS just did is raise the amount of expenditures that you can make without keeping receipts from $25 to $75. I think that goes directly to this kind of a paperwork burden problem.

One of the interesting things is how rapidly the process regulatory cost, basically the Internal Revenue cost, went up after the 1986 tax bill. Ironically, that bill was called the Tax Simplification Act of 1986, and it apparently did not simplify the tax codes because you notice on the charts, the numbers went up very dramatically after that law was passed.

Chairwoman MEYERS. Thank you very much, Mr. Glover. I may have some questions later. Thank you, Senator Bond.

Chairman BOND. Thank you, Madam Chairwoman. Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

I want to thank you for your report, particularly in light of the fact that in the minority community, the small business minority community, most of the people are workers and owners of those small businesses, so this report is long overdue.

I just would like to ask you, I notice in your report you include transfers as a cost on small business that could be reduced; is that correct?

Mr. GLOVER. Yes, ma'am.

Ms. VELAZQUEZ. Does not the inclusion of transfer amplify the estimated burden on small business?

Mr. GLOVER. To some extent it does, and we have considered that. We have provided the numbers with and without transfer costs because we think that you may, in fact, be correct and we wanted to provide both sets of numbers.

On the other hand, there are some specific instances where we know that transfer costs directly and specifically affect small business. The agriculture marketing services, marketing orders clearly shift burdens from large firms down to small firms. And so we do have some instances of that happening. So we did include it, but an argument can be made for excluding it.

Ms. VELAZQUEZ. So when your office put this report together, you made every attempt to take into account any factor that would affect small businesses?

Mr. GLOVER. Yes, we did but I will tell you that this is an art, not a science. We were not able to be as precise as we would have liked to because the data is not that precise.

Ms. VELAZQUEZ. I have read several reports from conservative think tanks, the Heritage Foundation, for example, and they placed the estimated burden on small business at a much higher number than your report reflects. Can you explain why this would be the case?

Mr. GLOVER. I cannot. I looked at those studies. They did not have the data and foundation that some of the other information had. It was not explained as well, so we could not go back and recreate how they did their numbers. We were able to do that with the Tax Foundation study, for example, and we did use their numbers and look at that. They actually came out with a number slightly lower than we did.

But we did look at everybody and, where we could follow it through, we took it into consideration in our overall assessment.

Ms. VELAZQUEZ. During last week's House Small Business Committee hearing on IRS regulatory reform, Commissioner Margaret Richardson expressed her concern regarding the Republican tax bill that we voted on last week. She feels that under such a plan it would be harder to reduce both the amount and complexity of IRS paperwork that small business must deal with.

Given the fact that your report highlights tax complexity as a major problem for the small business community, what are your feelings on this matter?

Mr. GLOVER. We have commented on various portions of the tax bill and to both committees, we have sent letters identifying what we think about various areas. We were, quite frankly, more concerned with the revenue estimates and the impact on small business than we were on the paperwork burden. We probably now need to go back and review that and look at it more carefully, because we were looking at it as to what was good from an economic point of view for small business. We did not look at it from a paperwork point of view. I suspect Ms. Richardson is absolutely right.

Ms. VELAZQUEZ. Do you think that a flat tax would be easier on small business?

Mr. GLOVER. It would certainly be more costly. We have done an analysis on flat tax and that if you use a 17 percent number we

found that about 68 percent of small businesses would actually have their taxes go up and lose their deductions, some of the deductions that they currently have. So their taxes would go up.

I think if it's a tiered flat tax, it is something we could talk about. But the flat taxes we have seen proposed would shift an economic burden to small business. They may save paperwork and I think one thing we cannot forget is if small business is asked would you rather have cash or less paperwork, they will take the cash every time.

Ms. VELAZQUEZ. Did your study take into account the specific impact of regulatory reform on minorities communities like the one that I represent?

Mr. GLOVER. We did not. It is a noble effort, but this was quite an undertaking as it was and we were, in a year, sort of hard-pressed to do more than we have done.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman BOND. Thank you, Ms. Velazquez. Mr. Torkildsen.

Mr. TORKILDSEN. Thank you, Mr. Chairman. Mr. Chairman and Madam Chairwoman, I will again applaud the nature of having the first joint hearing in 20 years. I think it is long past due.

Mr. Glover, thank you for your testimony. Just to follow up a little bit more on the process costs and what you identified, I believe, as largely being IRS compliance costs. Has there been any discussion at the SBA of any particular type of simplification? Obviously, you have studied different flat rate tax proposals, but has there been any advocacy from your office about what type of simplification that should take place?

Mr. GLOVER. Yes, there has been. We met with the IRS and the Treasury office within 30 days of being appointed. Again, having filled out all this paperwork, the one thing that irritated me the most was filling out the same piece of paper two and three and four times. Maybe the bottom lines are a little different, but the rest of the stuff is all the same.

We came up with a proposal, we talked to the small business community, and they thought it was a good idea to have one simplified form. Ironically, there is a program going on in the administration called STARS, which is designed to do this on a large basis. I have suggested that is a great idea, but small business does not file reports electronically yet. We looked at something simpler.

We have had a number of meetings where—this week we just met with the revenue commissioners of Pennsylvania, Delaware, and Maryland in conjunction with the White House Conference and their delegates and the IRS and the Treasury Department to simplify all payroll and quarterly and unemployment filings. We are going to meet again next week. Hopefully, we are going to be able to standardize a form and come out so that the most common filed form for small businesses will eliminate 50 percent of the paperwork by simply doing the same form and xeroxing a copy and sending it to the other agency. There is some real promise there, and hopefully I will be able to report to you in a few months that we are actually going to be able to see that happen across most States.

Mr. TORKILDSEN. I believe we would all appreciate seeing that, so thank you for that. Looking at the different Executive Orders for reducing the burden of regulation on small business, would you

comment, did you see any great difference between President Clinton's Executive Order and President Reagan's Executive Order from 1981?

Mr. GLOVER. Yes, I did. It actually focused more specifically on small business in this Executive Order. I think this Executive Order was a little stronger, a little tighter, than the one that was issued some years ago. But traditionally most presidents, I know since Carter, have done Executive Orders on regulatory reform.

Mr. TORKILDSEN. With that focus, I did notice from the first chart that you displayed that at the end of President Reagan's time in office, the percentage of cost of compliance was roughly 8.5 percent. Right now, it is a little under 10 percent. Is it your objective to make sure that it is going to be no more than 8.5 percent? Can you give us that commitment?

Mr. GLOVER. I can give you my commitment to make my best efforts to do that, and I certainly will do that, something I have been doing and I continue to do. We work hard with the agencies to try to get them to ferret out regulations, and we are having some success at that. But I will tell you that I will not commit to success, I will commit to my best efforts.

Mr. TORKILDSEN. We thank you for that. One final question, one of your charts also very clearly demonstrated that the manufacturing sector has really taken it on the chin with compliance costs. I suppose it is a surprise to no one that indeed the manufacturing sector of our economy nationwide has taken it on the chin as well, with actual job losses, I mean staggering numbers that we have seen across this country.

Has there been any effort from the SBA, or anyone in the Administration, to say what can we do to relieve the burden on manufacturing before we lose any more manufacturing jobs in this country?

Mr. GLOVER. I think we have to differentiate between loss of jobs that are based on more efficient production techniques and operations and, quite frankly, shifting of jobs from large firms in manufacturing to small firms. One thing that surprised me when we looked at the micro data was that we have seen a lot of manufacturing jobs go from large businesses to small businesses, and clearly our American businesses are probably more efficient than anyone else in the world. But you are right. There are costs placed on those manufacturing firms and to the extent we can find those, we want to ferret those out and work to reduce them.

We have focused our efforts primarily on retail and service because there were some fairly significant regulatory burdens that were low hanging fruit, I might say. We had, for example, regulations requiring that service stations post and file with both the State and Federal Government reports that said we have gasoline on the premise. You know, I think the public could figure that out. From a fire safety point of view, I do not think anybody did not know that gas stations have gasoline in there. With minor exceptions, we can pretty well tell you how much they have there on premise.

So what we have told EPA is that does it not make a lot of sense for EPA to require them to file what is obviously redundant. The only time I have ever been in a gas station that did not have gas, they had a big sign out front, no gas today. So I think those are

the kinds of regulations which we have worked on because they were good ones to take on.

You are right in manufacturing, and this clearly points us to the need to do more. We will be talking with NAM and others to try to focus more attention on the manufacturing sector.

Mr. TORKILDSEN. That would be appreciated as well, and thank you for your answers.

Chairwoman MEYERS. Thank you. Mr. Baldacci.

Mr. BALDACCI. Thank you very much, Madam Chairwoman.

Mr. Glover, I appreciate your report and also appreciate your thoughtfulness in taking the job and offering suggestions as to where to go. I did notice that there was a disagreement on the report, on page eight, between you and Dr. Hopkins as far as the calculations. I was just wondering what the rationale was for the difference. You had stated in the report that he had overstated the percentages.

Mr. GLOVER. He ignored the fact that one-third of the respondents said they had little or no regulatory burdens. He just calculated the percentages based on the two-thirds that said they had serious or significant burdens. And so we felt that by completely ignoring the one-third that had no regulatory burdens—that he had perhaps overstated. So we reduced the regulatory burden number from 1.8 to 1.5.

Mr. BALDACCI. Did you actually get your responses back based on sectors of the small business or business community or in the report—I got the impression that you just broke it down among different types of businesses? But did you get the responses back based on types of businesses?

Mr. GLOVER. We did, and we looked at those numbers to develop the ratio and the relationship. So there are two different analyses we did. One was where the burden was and the other was how we allocated that among industries. There was not a detailed enough sample for us to use the original study to allocate among industry based on that sample.

Mr. BALDACCI. And your only suggestion in your report was that the Regulatory Flexibility Act apply to Congress when it is dealing with legislation and force the agencies to deal with it more and having it in statute?

Mr. GLOVER. Yes. We wanted judicial review of the Regulatory Flexibility Act. Those are the specific areas that we identified as responding to the specific problem that we identified. We did not comment on other regulatory proposals that are outstanding that may help all businesses but not targeted specifically to small business.

Mr. BALDACCI. And you had mentioned, in a response to a question, that you are now working on a coordination of Federal agencies in their reporting requirements with small business, unemployment tax?

Mr. GLOVER. Yes, we are working with the IRS, Social Security, and the Department of Labor to coordinate with State governments so that we can come up with one standardized form which we can use to send to both agencies.

Mr. BALDACCI. I think that would go a long ways toward alleviating a lot of the paperwork and review that comes into small busi-

nesses, and I would be very interested in that information that you have. Thank you, Mr. Chairman. Thank you, Madam Chairperson.

Chairwoman MEYERS. Ms. Kelly.

Ms. KELLY. Thank you, Mr. Chairman. Thank you, both Mr. Chairman and Ms. Chairwoman. I can hardly see over this barrier here, Mr. Glover, but I hope you can see me enough to answer the questions and hear me.

Just a couple of things. As a small businesswoman, I was delighted when the President stepped forth and spoke meaningfully, I hope, about reducing some of these regulations on small businesses. I am glad to hear you today reassert a strong commitment. I hope that that is heartfelt and will result in a lot of reduction of some of the things that have been hitting we small businesses out there.

My question is a couple of things. One is with regard to these small business people, on page 20 of your testimony, it says reported regulatory costs per employee were the highest for the smallest firms with 1 to 4 employees. But I want to know if you would talk about that a minute and just tell me what you think with regard to the fact that you seem not to be comfortable with Mr. Hopkins figure there. Am I drawing an erroneous conclusion?

Mr. GLOVER. No, I am very comfortable with that figure. The only thing I said was the total burden is probably a little high only because he did not consider those one-third of firms that said they did not have much of a problem. There is no question in my mind that the biggest burden is on the very small firms.

Ms. KELLY. Well, we have very heavy costs on those smallest firms, and that takes me to the next question. That is the issue of the process regulations. I wonder if you could define what you really mean by process regulation with regard to—I mean, just give me some kind of a definition?

Mr. GLOVER. Sure. The process regulation is the basic paperwork burden that is there. It includes all Federal form filings. It includes the tax returns. It includes the process of complying with the regulations. Social Security filing is all included in that, Department of Labor, the Census that we file, the census of manufacturers, census of other businesses. All of those regulations go in. It is defined on page 27 a little bit more specifically.

Ms. KELLY. And that also includes then—I am wondering about manufacturing as opposed to sector-specific types of things, the geographic thrust here. Is there a change in these figures geographically as you look at the United States?

Mr. GLOVER. One of the studies did look at that a little bit, but I do not think we had enough responses to be statistically reliable. There were some differences geographically, yes, but I do not think they were statistically sound enough for us to be using them.

Ms. KELLY. So you were using, these are fixed costs then basically you are talking about, is that right?

Mr. GLOVER. No, in many cases, they are also variable costs, depending on—some of these are fixed costs and some of these are variable costs. The chart that we have up on the board basically is a theoretical chart which we found that when you applied the numbers in the study came right on the line. The smaller you are, the higher unit cost are there for small business. And you will find

that small businesses had a much higher cost at the 0 to 4 employee level.

The irony of this is, of course, that virtually all of the new jobs are being created by the very smallest of America's businesses, and that is where the biggest proportion of burden is.

Ms. KELLY. I really understand the irony of all of that, being there myself. I thank you very much. I appreciate your being here and being willing to testify. Thank you, Madam Chairman.

Chairwoman MEYERS. Thank you. Mr. Luther?

Mr. LUTHER. Thank you, Madam Chair, and thank you both Chairs for the excellent hearing. I certainly appreciate it and I certainly want to thank you, Mr. Glover, for an excellent report and I appreciate your testimony.

My question is really a follow up on Ms. Kelly's question. That is very interesting information, the information you presented on the manner in which the regulatory costs per employee or per other particular elements of a business, as you have mentioned there in the chart, how that tends to decrease with the size of the firm.

To what extent does that trend tend to follow what the trend would be for other categories of cost in a business? Because we all know that that is going to be the same for certain other categories of cost. To what extent would it either be—or can you say that it would either be greater or less than certain other categories of cost?

Mr. GLOVER. If you look at fixed cost, it will be very similar to the chart that you see there. Variable costs do not change as much between firms. You can buy 10 units versus 100 units or 1,000 units. The cost of raw materials is not as variable as are fixed costs. So a lot of variable costs, there is a change but not anywhere near what we are seeing. But fixed costs would be very similar to what we are talking about.

Mr. LUTHER. So in other words to the extent that you have reviewed this you are unable to say whether this tends to be greater or lesser than what a typical trend would be for other fixed costs?

Mr. GLOVER. I think I agree with that, but a lot of the other fixed costs we, as a Government, cannot do anything about. These are fixed costs that we can do something about. So that is why I think that—I differentiate them, I always separate in life things I can do something about and things I cannot. And those that I cannot do anything about I do not worry about, and those that I can do something about I try. So I make a distinction between the two.

Mr. LUTHER. So in that respect, one could say that perhaps there is more potential here to address this particular problem than with some of the categories of fixed costs in a business?

Mr. GLOVER. That is correct. Let us talk about capital costs for just a moment. For example, we know small businesses pay more in the loan interest rates. So that is, in effect, a capital cost that is higher for small business. And we recognize that. It does not mean we are not trying to do something about that as well. We have done a lot, our banking study and some other things, to help bring down those costs, to focus attention, to have competition between the banks. We do a lot wherever we can, but a lot of the fixed costs we cannot do anything about.

Mr. LUTHER. Thank you. Thank you, Madam Chair.

Chairman BOND. Thank you very much, Mr. Luther. I will accept a statement that Senator Frist left with us, an opening statement for the record.

[The prepared statement of Senator Frist follows:]

PREPARED STATEMENT OF SENATOR BILL FRIST
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

Mr. Chairman, I commend you and the distinguished Chairman of the House Small Business Committee, Congresswoman Meyers, for holding this hearing. I also want to thank our principal witness, Chief Counsel Glover, and the report's chief researcher, Dr. Thomas Hopkins. Dr. Hopkins has produced volumes of valuable research analyzing the costs of regulatory compliance on our economy.

Today is a historic day for small business owners. Today's report from the Small Business Administration (SBA) provides comprehensive empirical evidence of the disproportionate and severe impact of federal regulations on small businesses. I receive numerous letters, calls, and horror stories from entrepreneurs in Tennessee and across America who are crying out for regulatory relief. Last April, Chairman Bond and I held a field hearing in Memphis where ten small business owners testified about their struggle to remain competitive and profitable in the face of government regulations. Last June, I met with delegates from the White House Conference on Small Business who relayed similar stories. Today's report confirms their claims.

Let me briefly highlight the report's major findings. First, the regulatory burden is greater for small firms than large firms. Small businesses employ more than 50 percent of the nation's workforce and create almost 67 percent of our new jobs but bear over 60 percent of total business regulatory costs. With regulations costing America $649 billion a year, small business owners pay $245 billion a year to comply with federal regulations. Specifically, the average annual cost of regulatory, paperwork, and tax compliance for small businesses is $5,000 per employee while the cost for large businesses is only $3,400 per employee. If Congress intends to foster growth among entrepreneurs, we must reduce this regulatory burden.

Second, the report criticizes our status quo regulatory process and strongly recommends reform. I would like to quote directly from the report: "public policy makers need additional direction to reconcile their regulatory decisions with the national goal of preserving competition through the growth of small business. <u>The need for regulatory reform...is great.</u>"

Mr. Chairman, at this very moment, a comprehensive regulatory reform bill remains stalled in the Senate by defenders of the regulatory status quo. We cannot even bring up the bill for a straight up-or-down vote. America's entrepreneurs cannot wait for us to act any longer. While this bill remains blocked, millions of small business owners remain saddled with excessive and costly regulatory burdens, and all Americans suffer from lost economic opportunities. We must listen to our small business owners when they need help. We must listen to our nation's economic engine. Enacting regulatory relief will help launch an unprecedented era of economic growth in this country.

Over the next few weeks and months, I look forward to sharing the report's findings and Dr. Glover's testimony with my colleagues. Hopefully, this report will magnify the voices of our nation's entrepreneurs.

Chairman BOND. I would like to call on Mr. Coverdell.

Senator COVERDELL. Thank you, Madam Chairwoman, Mr. Chairman. Mr. Glover, I echo the comments applauding the document you have produced.

To digress just a little bit, as you know there is a regulatory reform measure before the Senate. It currently lacks about two votes to break a filibuster.

Mr. GLOVER. Yes, sir.

Senator COVERDELL. It is my understanding the administration does not support that legislation. Am I correct?

Mr. GLOVER. I believe that to be correct.

Senator COVERDELL. As you know, there was a Nunn-Coverdell amendment to that proposal which was adopted by the Senate which does create the prompt judicial review that you have requested. It says that agencies would have to provide factual support for not following Reg Flex. It would put the small businesses under cost-benefit analysis and periodic review, but not risk assessment.

My question, Mr. Glover, is have you had a chance to review that amendment, the Nunn-Coverdell amendment? And would you make comments, setting it apart from regulatory reform the total concept, what are your views with regard to the amendment?

Mr. GLOVER. I have had a chance to review it briefly. The amendment is a good idea, a good purpose. The only time I am troubled by cost-benefit analysis is if they take priority over the Regulatory Flexibility Act where you are going to look at the disproportionate burden. If you are looking at the disproportionate burden and you do a cost-benefit analysis, there are many times that small business might lose if you lump them in with big business. But if you are doing cost-benefit analysis purely on the small business aspect of things, I think that is fine.

Senator COVERDELL. The original proposal had economic impact nationally of $50 million which I think is the same figure as unfunded mandate. But it was raised to $100 million and it is still at play. I would have opposed that. What is your general view of that threshold, the $50 million impact versus the $100 million impact?

Mr. GLOVER. I am far more concerned about the specific impacts on small business than I am the overall impact. If there is an impact on small business at $5 million or $10 million, I think that deserves attention. I am not the representative of large firms and I will leave those to represent themselves.

The Reg Flex Act does not have any cutoff in terms of size. You have to do the analysis, you have to do the consideration regardless of the amount of impact. I would certainly be vehemently opposed to putting an impact dollar on Reg Flex, and I think that those numbers I will leave to others to discuss.

Senator COVERDELL. You have referred to Reg Flex several times this morning as if it were, of course it is the law, but operable. Are you comfortable that Reg Flex is achieving any measure of what it intended to do?

Mr. GLOVER. It is certainly achieving some measure of what it is intended to do. It gives us another talking point with the agencies. Is it achieving what we expect it to do or what Congress ex-

pected it to do when it passed it? I do not think so. I think it needs a lot more teeth. I think it is clear—there are some agencies which can and do choose in specific instances to ignore us.

We have had numerous meetings with the Department of Agriculture over their agriculture marketing orders and they simply will not comply with the Regulatory Flexibility Act. We met with the Assistant Secretary. I think we have done everything we can do. The committees have discussed that with them.

We have exhausted everything we could do. If there were judicial review, we could solve that issue very quickly.

Senator COVERDELL. You have referred several times during the testimony here this morning to the enforcement Executive Order. I wonder if you would elaborate a little more specifically for me the nature of the Executive Order and your view of its impact?

Mr. GLOVER. I think the Executive Order was designed shortly after the President came in to help reduce the regulatory burden and streamline the process. It required a number of activities. We discuss that on pages six and seven of our report.

I think it requires the agencies to do the cost-benefit analysis and look at alternatives. It required agencies to maximize the net benefits to look at alternatives within the cost-benefit analysis. It required the agencies to tailor their regulations to impose the least possible burden on society.

But I think the part that I liked best about it was the fact that it did specifically focus on the small business sector and identify that as a sector of special interest. I think that probably has been more successful than other Executive Orders, but I think some of the other things the administration has done are far more important than that Executive Order.

As I mentioned, the most important thing they have done is changed the enforcement philosophy. I mean, for as long as I have been involved in small business, and that is over 20 years, we have had a situation where the Government was out to gotcha small business. I mean, they went in and said how many fines can you issue?

The only way you change the culture of the Government is to change the performance criteria of the Government officials. As long as you were being evaluated on how many citations did you issue and how many fines did you collect, every incentive was there to issue fines. I think one of the cruelest things is to levy huge fines against small business, knowing full well that they would eventually be compromised.

The psychological impact of a small business when you walk in and level a $500,000 or a $1 million fine on a business when they do not have that money no matter what, is just horrible. Fortunately, we have now got a President directing people not to do that anymore. But I have heard about, and we have all heard about those cases, and we know that those fines would never be collected under any circumstances. The company would file bankruptcy before that, and the Government would not get its money, so why do that?

The reason we did it is because the Government evaluated its performance based on how many fines they issued and how many dollars collected. That is just a travesty, and I am glad we have

taken some steps to stop that from happening. Hopefully, we will make sure that Government really does, in fact, stick with their change.

Senator COVERDELL. I recognize my time is expired. Thank you, Mr. Chairman.

Chairwoman MEYERS. Thank you. We would like to ask unanimous consent to keep this record open in case members have other questions that they would like to submit in writing. At this time, I would recognize Mr. Flake.

[The prepared statement of Representative Flake follows:]

PREPARED STATEMENT OF THE HONORABLE FLOYD H. FLAKE
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

I also want to acknowledge that I am pleased to participate in the first joint small business committee hearing in twenty years. As always, I am interested in ways that we can reduce regulation such that small businesses are able to prosper and grow. I am also quite interested in how regulation can be altered to insure small business longevity. In my district, I am fortunate to have a number of small businesses in my district and associated with my church in Queens, New York.

If you want to insure that small businesses thrive in a competitive environment, it is incumbent upon us to level the playing field between small and large firms. It is imperative that we analyze each current and intended regulation in terms of its short-term and long-term costs to the small business as well as its intended benefits. The fact that small businesses will be the engine for future job creation and contribute greatly to growth in the economy should be accounted for in this analysis.

With that said, I look forward to hearing from Mr. Glover, a man who has done an excellent job of addressing the Administration and the Congress' interest in reducing regulatory burdens on small business. I would like to commend him on his efforts to insure that all agencies understand the unequitable restrictions placed upon small businesses and I look forward to hearing his report's conclusions.

Mr. FLAKE. Thank you, very much, Ms. Meyers, and thank you, Senator Bond, for holding what I consider to be perhaps one of our most important hearings. The magnitude of it certainly expressed by the fact that the House and the Senate are both here together.

Mr. Glover, you are always very good in terms of your testimony, especially with regard to your information about regulating small businesses.

Mr. GLOVER. Thank you sir.

Mr. FLAKE. The concerns I have are, like Ms. Kelly's, related to my experience as a person who is directly involved with small business. After reviewing your report, Mr. Glover, I would like to express two concerns. The first one has to do with a number of small businesses which have small staffs, lack capital, and who find themselves having to—as was stated a moment ago—either go into bankruptcy or to close their doors until they think they can recover enough to be able to come back in business. It is devastating to these communities and to those individuals who have invested all of their savings and resources in the business.

Can you give me specifics in terms of how this act will assist those particular businesses before the point of closure? How do we guarantee that relieving disparate burdens which are placed upon small businesses will allow them to not have to constantly look over their shoulders and worry about the Government coming to shut them down?

Mr. GLOVER. You have hit on the real core of what I am trying to communicate. My numbers do not go to that, and that is the fear element that exists in small businesses. We do not quantify that, we cannot quantify that. But I think that is a bigger problem than the actual numbers.

The thing we can do, as public policy individuals, is make sure we fight every day to make sure that burden is as low as it can be. I do not think we can eliminate the burden totally, but I think we have to try to fight every day to reduce that burden.

I think one of the things that is great about America, and it is one of those debates that we, when we talk to academics, never seem to understand about small business is that the ability to fail is a very important right in America. When the Bankruptcy Act was being amended last Congress I was very concerned because they were making it very difficult for small businesses to go in and out of bankruptcy. We fortunately submitted a report to the Judiciary Committee and we got that changed.

But American small businesses are vibrant. They live and grow and sometimes they fail and come back. We need to make sure that we are not the reason for that in the Government. We just have to do the best we can each and every day.

Mr. FLAKE. The other issue of concern is the regulations related to participation in pension plans. I think you mentioned that, without any real full explanation, in your testimony as it related to some proposed reforms. Obviously, I think those of us in small business realize that there are also penalties for being a small business owner when it comes to the question of pensions. In many instances persons lose everything because the estate laws hinder the possibility of passing a business along to another individual.

What are the specifics, as you know them, relative to changes in pension plans that will make it better for those persons who are not only making a hard earned financial investment, but also investing their time and labor into building a business?

Mr. GLOVER. We have looked at that at some length in our office. It was done before I got there, but the burden on pensions and the fact that the vast majority of businesses that drop pension coverage do it because of Government regulations, the small businesses drop it because of Government regulations and the paperwork. We have seen that as a real problem.

The Administration came out with a pension reform program. The House passed a pension reform program. Senators Roth and Senator Dole have taken the administration's NEST program, changed it, I think made it better. The simple program that Senator Dole and Senator Roth have included in the Finance Committee Bill are a really good way to eliminate that burden. It was not in the House bill, but hopefully it will stay in the compromise bill.

Likewise, many of the pension reform changes that simplified the recordkeeping—and I will tell you, it is shocking when you see the amount of regulations for pensions—it is eight volumes. The regulations cover half of this table, on what it takes to have a pension plan for small business. It is just one of those areas where we have to do better.

There are two good proposals pending right now, and hopefully the Senate and the House will agree to take the best of each other's plans and we end up with a real improvement on that. It is long overdue. We need something, seriously, to fix the pension problem.

Mr. FLAKE. Thank you very much, Mr. Glover. I yield back the balance of my time, Chairwoman Meyers.

Chairwoman MEYERS. Thank you, Mr. Flake. Mr. Bartlett.

Mr. BARTLETT. Thank you very much. I want to thank the two chairs for convening this very important meeting, and I want to thank Mr. Glover for his contribution. Whenever he is testifying, I am reminded of the opening in many talks where the audience is asked do you know the two biggest lies in America? The first one is that the check is in the mail, and the second one is I am from the Government and I am here to help you.

I can tell you that when Mr. Glover comes, he can say that. I am from the Government and I am here to help you, and it is not a joke. Thank you very much for making this contribution to bureaucracy and to politicians. We share some of the same negative feelings on the part of our people.

We certainly have a need to reduce the impact of regulations on small business, but I have two questions that are not aimed at reducing the impact—we certainly need to do that—but are aimed at reducing the number of regulations. Fairly recently the Supreme Court, in what I think was a very important ruling, the Lopez decision, said that when the Federal Government prohibited guns on school property—and no one argues that that is not a good idea, no one will argue that that is not a very good idea. But the Supreme Court said that no matter how good that idea was, this was an unwarranted stretch of the Commerce clause and the Federal Government could not do it.

My question is that while our laws and regulations ultimately are tested by the court, it would appear to be irresponsible to have and enforce Federal regulations that would appear to be inconsistent with the Lopez decision. My question is, is there any plan to review our regulations relative to this test?

Mr. GLOVER. I do not know of any.

Mr. BARTLETT. Do you not think that that might reduce the number of regulations?

Mr. GLOVER. I suspect that it would reduce the number of regulations.

Mr. BARTLETT. I have a second question that is aimed at reducing the number of regulations. In the Contract With America that we just voted on in the last few months, there was some regulation reform. One of those reforms was that for all future regulations, in order to impose a new regulation, among other requirements you would have to demonstrate that the cost of the regulation did not exceed the benefit of the regulation.

I felt that this ought to be a lookback requirement as well as a look ahead requirement. I am wondering if there is any plans on the part of your department to look at our regulations to say lookback, if it is a good idea to look forward to future ones it ought to be a good idea to look back to see which of the regulations we now have in place where the cost is not justified by the benefit. I think, as the old farmer said, you would not do something if the juice was not worth the squeezing. I think there are many of our regulations that would not pass that juice worth the squeezing test.

Is there any plan to look back at our regulations, to recommend those where the cost is not justified by the benefits so that they might be, in any sane society, eliminated?

Mr. GLOVER. I think the President announced, at the White House Conference, that the agencies had committed to a line-by-line, page-by-page review of all their regulations, with a view toward eliminating those that were unnecessary or could be eliminated and that they have committed to 16,000 pages of elimination and to rewrite over 25,000 pages of those regulations.

I am not, other than making sure that we try to get the most we can for small business, I am not privy to the exact results of those analyses, but I think by the end of the year we will all have those results. I think we ought to look at those and see what we have done.

If you do not think they have gone far enough, then I think the proposal you are talking about makes sense to look at it.

Mr. BARTLETT. You do not know if cost-benefit analysis is one of the criteria?

Mr. GLOVER. I am trying to remember the directive. I think it is to make sure they all make common sense, and I would define that as to look at it from a cost-benefit analysis. I am sure that is a factor they are considering. Whether they are going to do an in-depth cost-benefit analysis, which is envisioned in the legislation, I do not think they would have time to do that during this period but certainly they ought to take that into consideration as one of the factors, and I think they are.

Mr. BARTLETT. Thank you very much. As a past small businessperson, I am very appreciative of what you are doing for small business. Thank you very much.

Chairwoman MEYERS. Thank you, Mr. Bartlett. Mr. Poshard.

Mr. POSHARD. Madam Chairman, thank you. Let me apologize for being late. We had a markup in the Transportation Committee this morning and we are just running late.

Mr. Glover, would you elaborate a little bit at least on the cooperation that SBA is going through right now with the EPA with respect to small businesses and the approach that they are taking to remediate over a period of time before any type of fines or processes take place? I know there are a lot of small businesses in my district that have contacted me on this for additional information. They like it, but we need to know more definitively the approach that is being taken here.

Mr. GLOVER. I think that the EPA has always been one of the agencies, and despite the fact the burdens have gone up, they have always looked at Reg Flex and always been willing to try to comply with Reg Flex. As far as the enforcement issue is concerned, EPA looked at SBA's recommendation to the President that the agencies consider the fact that there was good faith compliance and waive the fines for first offenders. EPA allows those fines to be used to correct the violation as opposed to being sent to the Treasury Department. They have been the first on board with those activities.

We have been working closely with them on that, but I did ask, when I met with the Deputy Administrator a few months ago, I did ask them to tell me specifically how are we sure that that message is getting into the field? My fear is always that we have a great idea in Washington, the President says something, the head of the Agency says something, but the inspector where the rubber meets the road is not aware of those things.

I have asked them to get back to me and explain that to me, and they have. There is a very clear effort to communicate down through the ranks. I know in the case of OSHA that I have actually, in the field, run into small business people who said boy, I have to tell you, since the White House Conference things have really changed. I actually get along with my local EPA office and we work with them now as friends. It came as a real shock to me to hear that sudden of a change, and this was an environmental compliance expert who works with a lot of small business people who would never have gone to the EPA under any circumstance, and now they are going in and working with them on issues and compliance.

So there is certainly a change.

Mr. POSHARD. Let me ask you with some further specificity. I live in a rural area in which we have a lot of small towns and mom and pop small businesses, gas stations, that sort of thing, and individual farmers who are small business people also. We have a huge issue before us, and I do not know what specifically your department has done at this point in time in working on this, but the underground storage tank problem, which is turning out to be a back breaker for a lot of small business people in this country.

What specifically is SBA doing to advocate for those people, if anything? Or if you have not undertaken that task at this point, what will you be doing in the future?

Mr. GLOVER. We have been fighting that battle for 10 years. What we have accomplished is some of our greatest success stories. We have saved literally hundreds of thousands or millions of dollars for small businesses because of changes the EPA made over time. It is always going to be a problem and if you would like, I would be happy to submit something to you specifically on what we have done in the last year or so on that.

But I know historically we were right in the middle of that fight, because it really was a major problem.

[In further response, Mr. Glover submitted the following:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

JAN 23 1996

Honorable Glenn Poshard
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Poshard:

At the hearing on the cost of government regulations a few months ago, you inquired regarding the Small Business Administration (SBA) efforts regarding the Federal underground storage tank requirements.

The SBA has heard from small businesses which own or operate underground storage tanks concerning their difficulties in complying with the regulations of the Environmental Protection Agency (EPA). Small businesses have had problems with the technical standards and financial responsibility requirements of the regulations, including the requirement of securing adequate insurance coverage. These rules affect over 400,000 facilities. Small businesses have also described problems in obtaining financing which have arisen for them and their lending institutions under the liabilities which derive from the various Federal environmental statutes.

EPA regulations regarding underground storage tanks address an important environmental problem - prevention and correction of leaks of petroleum and other chemicals from over two million underground storage tanks nationwide. These regulations include technical standards for leak detection, tank upgrades and new tank standards, as well as financial responsibility requirements, as mandated by statute, which require owners and operators of storage tanks to have insurance to pay for the costs of clean-up and third-party liability. Because these rules have such a major effect on small firms, the SBA has played a large role in addressing these rules.

A. SBA Regulatory Activity

The Office of Advocacy has been particularly successful over the years in reducing the stringency of these congressionally-mandated requirements. In a unique experiment with EPA, the Office participated in the EPA working group that developed the proposal and final rule. In the 1988 final rule, EPA adopted Advocacy's position that less expensive, but environmentally sound, tanks were acceptable to meet tank technical standards. A more reasonable leak detection scheme was also promulgated. We estimate annual savings of about $1 billion annually.

Furthermore, EPA agreed to delay the imposition of the financial responsibility requirements on the smallest petroleum marketers due to the general unavailability of insurance to these facilities. At this time, the insurance requirements in the majority of the states are satisfied by state funds for clean-up and third party liability.

B. Illinois State Fund

Last year, due to a large shortfall in the Illinois state fund, EPA withdrew its approval of the fund as a method of financial responsibility compliance for Illinois marketers. As a result, petroleum retailers were required to seek private insurance or be subject to Federal penalties. I suspect that this particular problem was the subject of the majority of the complaints that you have recently received. Fortunately, the Illinois state legislature passed H.B. 901, which adds additional monies to the state fund. We hope that EPA will soon recertify the Illinois fund to withdraw the threat of Federal sanctions.

C. SBA Financing of Underground Storage Tank Environmental Compliance Expenses

SBA is able to provide direct assistance to small businesses to finance their compliance with these requirements. The traditional section 7(a) loan guarantee is available to small firms who wish to upgrade or replace their tanks to comply with the EPA requirements. This loan guarantee may be utilized up to $1 million for pollution-related expenditures, which includes these EPA rules.

We welcome any additional inquiries you may have about these rules, or any other Federal issues involving small business. We are providing a copy of this letter to the Senate Small Business Committee for insertion in the hearing record. If you have any questions about this letter, please feel free to call me or Kevin Bromberg of my staff at 205-6964.

Sincerely,

Jere W. Glover

Jere W. Glover
Chief Counsel for Advocacy

cc: Senate Small Business Committee

Mr. POSHARD. I would appreciate that and, Madam Chair, I have no further questions. Thank you.

Chairwoman MEYERS. Thank you, Mr. Poshard.

Mr. FLAKE. Madam Chair, a point of personal privilege, please. May I ask that the Chair will have that information distributed to the entire committee? I ask unanimous consent that Mr. Glover's response to Mr. Poshard be distributed to the entire committee. It is not just a rural problem. It is a major impediment in urban communities where you are trying to take lots where previously there were stations which may have been there 40 or 50 years ago. But you cannot build anything on them because environmental issues will not let you do that.

So I ask unanimous consent that the answer come back to the committee and be distributed to all of us. Thank you.

Chairman BOND. Without objection, Mr. Flake, it will be done.

Now it gives me great pleasure to turn to my co-chair of the Senate Regulatory Relief Tax Force, my good friend from Texas, who has been with us throughout the hearings and has shown a great interest and commitment to this entire process, Senator Hutchison.

[The prepared statement of Senator Hutchison follows:]

PREPARED STATEMENT OF SENATOR KAY BAILEY HUTCHISON
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

Chairman Bond, Chairman Meyers: I want to commend you for calling a joint meeting to receive the report of the Small Business Administration's Chief Counsel for Advocacy.

Mr. Jere Glover, the Chief Counsel, is going to testify on the findings of his report, The Changing Burden of Regulation, Paperwork and Tax Compliance on Small Business. I have read with interest the written version of his testimony which has been submitted for the record and would like to share a few observations about it, and the problems of small business, with the Committees.

When Congress enacted the Regulatory Flexibility Act (RFA), in 1980, it gave the Office of Advocacy a stronger role. By requiring federal agencies to examine the impact of their regulations on small business, it placed a proper focus on the needs of the small business community.

Mr. Glover's testimony is directly related to his mission. His office was created to give small business a voice with policymakers. Still, we should note that despite his "independent role" he is an Administration official.

First, the SBA office of Advocacy reviewed current economic and policy analysis literature to find studies examining the impact of regulation on business.

Second, the office worked with Dr. Thomas Hopkins of the Rochester Institute of Technology, who is probably the preeminent researcher quantifying the impact of regulations on business. Dr. Hopkins', in Profiles of Regulatory Costs finds that the cost of regulations per employee for small firms are 50 percent to 80 percent higher than for large firms. The problem is more pronounced in the manufacturing sector than elsewhere.

Third, the Office of Advocacy came up with its own analysis, citing a somewhat lower, 50 percent factor of small business disadvantage in regulatory excess. Unnecessary, counterproductive and economically damaging regulations are a tremendous drain on economic vitality.

We should also recognize from the SBA report that although the regulatory burden falls most heavily and unfairly on smaller firms, it does not necessarily follow that general regulatory reform is not needed.

In fact, general regulatory reform is essential, and special emphasis on the needs of small business is a vital component of the reforms we need.

Senator HUTCHISON. Thank you very much, Mr. Chairman. I do want to thank you and Chairwoman Meyers for having this joint meeting. I think it has much more impact when both bodies are able to hear this kind of testimony. Perhaps we will be able to draw our laws for regulatory reform more closely together and hopefully, Mr. Chairman, I know you and I have worked very hard for regulatory reform and if we could just get our bill out of the Senate—we are one vote short—it would make a huge difference.

The House, fortunately, has passed very good regulatory reform and I hope that the Senate can follow suit very quickly and we will be able to send a bill to the President.

When Chairman Bond and I decided to co-chair the Regulatory Reform Task Force we sent a questionnaire to our members and said rank the worst laws from the regulatory standpoint. We called it our worst first list. Right at the top of our worst first list was OSHA. OSHA reform has become a very important part of my regulatory reform agenda. Chairman Bond, Senator Kassebaum, Senator Gregg are all cosponsoring bills that would try to reform OSHA.

I want to give you a few examples of why we think that is necessary. In my own State of Texas, an OSHA compliance officer from the Corpus Christi area office stated under oath that OSHA area directors are under enormous pressure to produce high numbers of citations and penalties, that OSHA employees' job performance evaluations apparently depend on meeting de facto quotas. This same OSHA compliance officer also testified that his supervisor directed him to cite companies even when both the supervisor and inspector knew full well that a company did not violate a regulation that warranted a citation.

Not long ago, the Indiana OSHA found the owner of an Indiana Handi-Mart liable for not providing a safe workplace after an armed bandit robbed and killed an employee of the store. Well, we have noted all over this country that there are criminal activities which I do not think should be found to be the fault of the owner of a store when we are not able to control crime.

In east Texas, after two workers died of asphyxiation after entering a confined space against strict company policy, OSHA concluded that there was no violation and closed the case. However, OSHA then reopened the case and issued citations after a civil lawsuit was filed. The employer's insurance company panicked and settled the suit for $1.5 million. Subsequently, OSHA dropped the citations, but the harm was clearly done.

These are just a few examples of why people are so concerned about the over-regulation and particularly small businesses that are not able to absorb these kinds of costs.

Mr. Glover, in our bill for OSHA reform we ask that inspector citations quotas be eliminated. Do you believe that that is an important reform for OSHA?

Mr. GLOVER. Yes, and my understanding is that they have done so and that the President specifically directed that they change that. But I recognize that that is one of the real problems that small businesses fear, and it really does—you know, I am a lawyer.

I knew a lot about Government regulations, and in small businesses you bet the store on whether you are complying with regula-

tions or not. It is a nervous feeling, and it lasts for a long time. I can imagine how small businesses who do not have the experience that I had—I mean, I was nervous about it, and I can imagine that others are. And I hear it from all small business people. It is a genuine concern and I think it is a problem that hopefully has been fixed, but certainly it is one that needs to be fixed.

Senator HUTCHISON. We need to make sure that the regulators will never again go so far beyond the bounds of Congressional intent, I think, and that is what we are going to try to do.

Another bill that is freestanding, as well as part of our OSHA reform bill, is the teamwork bill that would allow employers and employees to come together to work for safety in a team spirit effort. Now most people in America would say what? Why can't they do that now? But in fact, as you know, there are barriers to employers and employees having a team effort for worker safety issues.

Is this Administration going to help correct that situation, so that we can facilitate worker safety without the artificial barriers of employers and employees coming together in a team effort?

Mr. GLOVER. As you may know, the Office of Advocacy is independent, and our opinions often differ from those of the Administration. So as far as the Administration's position specifically is concerned, I am not sure about that. The idea of teamwork and working together is something that small businesses do and are famous for doing. Those that, for some reason, are prohibited from doing so, it would certainly be good if they could find a way to do that.

But I think normally employer/employee relationships with small business are much better than they are in large firms because it is awfully easy for the worker to get to the owner and the decisionmaker.

Senator HUTCHISON. Mr. Glover, I see that my time is up and I have a number of other areas I would like to explore with you, but I will say I do appreciate the fact that you have done this study, that you are testifying about the excesses of regulation and its impact on our smallest businesses. Let me just end by saying that small businesses provide more than 50 percent of the jobs in America.

I think if we could put into place regulatory reform we could make them even more competitive and make our economy much stronger. I believe that you are trying to help in that regard and I appreciate it. Thank you, and thank you Mr. Chairman, and Madam Chairwoman.

Chairman BOND. Thank you very much, Senator Hutchison. The record will be left open for any further questions any members have or statements. Madam Chair, you had a comment, I believe, in closing?

Chairwoman MEYERS. Just in wrap-up, I would like to comment, Mr. Glover, that I did introduce the amendment that produced this study last year. I think it has been very worthwhile. I thank you very much for your contribution.

I think it emphasizes three things, one the importance of passing the amendments to the Regulatory Flexibility Act. All of the regulatory reform is important, but especially for small business I

would hope that the Senate could act on the Regulatory Flexibility Act amendments.

I think the importance of oversight and follow through on all of the things, the actions that the President is taking and that Congress is taking, is extremely important. And of course, these committees are the ones that should do that.

And finally, just as a personal observation I would say that I hope that the Senate can also pass the expensing tax provision. I do not think they included that in their bill but I would hope that in conference we can talk again about expensing because that does relieve the IRS reporting burden so much for small business.

Thank you very much for holding this hearing, Senator Bond.

Chairman BOND. Thank you, Madam Chair.

To clarify one point, Mr. Glover, you indicated that the Department of Agriculture refuses to go along with Reg Flex. Is it not true that the IRS says that they are not covered by Reg Flex and this, being one of the major areas, is clearly a significant problem for small business?

Mr. GLOVER. Yes, sir. I would hate to have omitted them from inclusion in my list.

Chairman BOND. We shall make sure that they are noted.

Thank you very much, Mr. Glover. I would like to thank my colleagues from the House and on the Senate side. This joint hearing is adjourned.

[Whereupon, at 11:33 a.m., the hearing was adjourned.]

APPENDIX MATERIAL SUBMITTED

PREPARED STATEMENT OF THE HONORABLE DONALD A. MANZULLO
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

Chairpersons, I am pleased that you are holding this hearing to release the findings of a critically important study conducted by the Office of Advocacy of the Small Business Administration on regulatory burdens on facing small businesses.

Dr. Thomas Hopkins of the Rochester Institute of Technology has estimated that complying with government regulations cost the U.S. economy $649 billion in 1994. According to Dr. Hopkins, businesses bore 60 percent of that immense burden.

Unfortunately, regulatory costs for small businesses, especially small manufacturers similar to the hundreds of companies with fewer than 100 employees spread throughout the 16th District of Illinois, which I represent, are higher than those firms employing more than 500 employees. This is not a surprising conclusion. Large businesses have the staff to monitor, influence, and comply with government regulations.

However, most small business owners usually do not find out about regulations or new changes to the law until it is too late. They are hard at work, usually from dawn to late at night just to keep the business running. Thus, complying with government regulations for small business is another huge cost of staying afloat.

That's why we need to pass regulatory reform. The House passed a comprehensive regulatory reform agenda earlier this year as part of the Contract with America. The Senate is just one vote away from breaking the parliamentary log-jam on regulatory reform (there are already 59 votes in favor of such a bill in the 100 Member Senate). I encourage my colleagues sitting on the fence on the other side of Capitol Hill to pay close attention to the results of this study and heed the calls of small business owners in your home state to enact a common-sense regulatory reform agenda that truly balances the legitimate needs of government with promoting the growth of small businesses.

Again, thank you, Chairpersons, for holding this hearing, and I hope that this study will draw more attention to the impact of government regulation on Main Street, America.

PREPARED STATEMENT OF THE HONORABLE KWEISI MFUME
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

I would like to begin by thanking my colleagues from both bodies for holding this hearing today. It is encouraging to see such interest in the impact of regulations on small businesses, and I hope that as a result we will be able to work together to move forward with initiatives that will be of genuine use to small and minority businesses.

I was especially encouraged when reading the report by the Small Business Administration's Office of Advocacy, "The Changing Burden of Regulation, Paperwork, and Tax Compliance on Small Business," to see that many of the initiatives undertaken by the current Administration do appear to be addressing some of the most important problems.

By directing agencies such as the Internal Revenue Service to be flexible in its dealings with small businesses, the Administration is, in fact, telling the federal government to work for its citizens, rather than against them. For too long, the government has had the reputation of being only out to penalize small businesses rather than work with them to ensure that they adhere to the law. We who serve on the House Small Business Committee heard testimony just last week from the Administration on the steps it is taking to create a friendlier atmosphere for small businesses. I am glad to know that they are on the right track.

I thus look forward to receiving Mr. Glover's testimony on the report and on any additional information he may have uncovered as to how we as lawmakers can ease the regulatory burden on small businesses. I also look forward to working with all of my colleagues from both bodies to develop policy that will help small businesses as well as the rest of the nation.

PREPARED STATEMENT OF SENATOR LARRY PRESSLER
BEFORE THE JOINT HEARING OF THE SENATE AND HOUSE
COMMITTEES ON SMALL BUSINESS
OCTOBER 31, 1995

I would like to thank Chairman Bond and Chairwoman Meyers for holding this important hearing. I look forward to hearing more about the Report to Congress on the Changing Burden of Regulation, Paperwork, and Tax Compliance on Small Business. This report simply confirms what small business owners have been telling Senators on this committee for years -- government regulation has a chokehold on business. Each of us here today could share horror stories of Washington bureaucrats run amok, imposing complicated, costly, and silly rules.

This report estimates that small firms spend $5,000 per employee to comply with federal regulations. Any small business owner will tell you that this burden severely restricts their abilities to expand and hire new employees. As American firms face increasing competition from abroad, we must do everything we can to strengthen our home team. We must give our businesses not special advantages, but freedom from the unreasonable demands of government. To sharpen our competitive edge, we must repeal federal regulations.

American business is not the enemy. The vast majority of small businesses are run by fine, ethical businessmen and women who want to obey the law, not skirt it. They want to be good corporate citizens. They do not seek ways to bend or break the law. They work hard to treat their employees fairly. They spend considerable amounts of money to provide a safe workplace. They do this not because the Occupational Safety and Health Administration (OHSA) requires it. They do it because it is good, sound business sense.

We have debated the issue and done the proper studies. Now it is time for us to act. I look forward to working with my colleagues on the panel to enact common sense regulatory reform.

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